Uganda Economic Update, 11th Edition

FINANCING GROWTH AND DEVELOPMENT:

Options for raising more domestic revenues

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WORLD BANK GROUP

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to stay on its development course and not compromise fiscal stability, Uganda needs to urgently increase the mobilization of domestic revenues

1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

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Foreword

Uganda has reached a critical point in its development. Aid flows have slowed, and public debt is rising, and is expected to increase above 40 percent of GDP by the end of 2019. The Government's ability to borrow domestically is also constrained, due to the crowding out effect this can have on private sector credit growth. At the same time, however, Uganda needs to scale up the financing of important infrastructure, and continue to build human capital through the provision of better education and health services. Thus, to stay its development course and not compromise fiscal stability, the country needs to urgently increase the mobilization of domestic revenues.

Domestically generated revenues will ensure that Uganda owns and drives its development agenda in a sustainable manner, and provides a better and more prosperous future for subsequent generations. Taking bold decisions now to diversify and increase domestic tax revenues before the oil starts to flow, will also better position Uganda to use the envisaged oil windfall for strategic physical and human capital investments, and saving for a future when the oil runs out – rather than expecting future oil revenues to plug expenditure gaps and repay the ever-increasing debt burden. Extensive evidence from other countries shows that the latter is certainly not a prudent approach.

Against this background, I am pleased to introduce the Eleventh Uganda Economic Update, which assesses Uganda's domestic revenue performance as the special topic, and shows that the country is doing poorly compared to its peers and its potential. Currently, Uganda's tax-to-GDP ratio is just under 14 percent, which is lower than the ratio in neighboring Kenya (18 percent) and Rwanda (16 percent); and is also below the broader COMESA and Sub-Saharan Africa averages. Furthermore, comparing Uganda to economies with similar characteristics, it has the potential to collect revenues of above 20 percent of GDP over the medium term.

Reforms are required to put the revenue-to-GDP ratio on an upward trajectory so that Uganda moves towards its potential, and raises sufficient resources to finance its growth and development priorities. I trust the report will be useful in advancing the recent public discourse around revenue mobilization and overall fiscal policy management.

In line with the structure of earlier editions of the Uganda Economic Update series, this report reviews recent economic developments, provides an outlook for the macro-economy, and then delves into the special topic of domestic revenue mobilization.

Diarietou Gaye
Country Director,
Eritrea, Kenya, Rwanda, and Uganda; Africa Region

Abbreviations and Acronyms

ASCUDA	Automated System for Customs Data	MDA	Ministries, Departments, and Agencies
BOU	Bank of Uganda	MoFPED	Ministry of Finance, Planning, and Economic Development
CET	Common External Tariff	MSME	Micro, Small, and Medium Enterprises
CIT	Corporation Income Tax	NGOs	Non-government Organizations
COMESA	Common Market for Eastern and Southern Africa	NPL	Non-Performing Loans
CSOs	Civil Society Organizations	OECD	Organisation for Economic Co-operation and Development
CY	Calendar Year	OSR	Own source revenue
DRC	Democratic Republic of Congo	OTT	Over the Top
DRM	Domestic Revenue Mobilization	PAYE	Pay as You Earn
DRM-S	Domestic Revenue Mobilization Strategy	PIT	Personal Income Tax
DSA	Debt Sustainability Analysis	PPP	Purchasing Power Parity
EAC	East African Community	SBP	Single Business Permit
EACCMA	East African Community Customs Management Act	SSA	Sub Saharan Africa
EFU	Energy, Fuel, and Utilities	T&T	Track and Trace
EMDE	Emerging Markets and Developing Economies	TREP	Tax Payer Register Expansion Project
EU	European Union	UBOS	Uganda Bureau of Statistics
FDI	Foreign Direct Investment	UCC	Uganda Communications Commission
FY	Financial Year	UGX	Uganda Shilling
GDP	Gross Domestic Product	UN	United Nations
ICAS	Investment Climate Advisory Services	URA	Uganda Revenue Authority
ICT	Information and Communication Technology	URSB	Uganda Registration Services Bureau
ICTD	International Centre for Tax and Development	USD	Unites States Dollars
IDA	International Development Association	VAT	Value Added Tax
IMF	International Monetary Fund	WB	World Bank
KCCA	Kampala City Council Authority	WHO	World Health Organisation
		YOY	Year-on-Year

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The report benefitted from the insights provided by internal peer reviewers, including Marijn Verhoeven (Lead Economist and Cluster Lead Tax); Sebastian S. James (Senior Economist Domestic Revenue Mobilization); and Rafael Chelles Barroso (Senior Economist, Macroeconomics, Trade and Investment). Additional insights came from International Monetary Fund staff including Axel Schimmelpfennig (Advisor, African Department); Larry Qiang Cui (Senior Economist, Uganda); Thomas Baunsgaard (Deputy Division Chief, FAD), Andrew Hodge, and Peter Mullins.

The report draws on two diagnostic studies conducted under the auspices of the Domestic Revenue Committee, whose core members consist of representatives of the Ministry of Finance, Planning and Economic Development and Uganda Revenue Authority. The committee operates under the stewardship of the Secretary to Treasury and Permanent Secretary to the Ministry of Finance, Planning and Economic development.

Irfan Kortschak provided professional editing services.

KEY MESSAGES

Container depot, waiting for clearance by the customs authorities (World Bank, 2016)

> It remains to be seen whether Uganda can increase its domestic revenues. To improve performance in this area, avoiding policy discretion is just as important as extending the tax net through innovative approaches

Uganda's fiscal policy has remained mainly expenditure driven, with domestic revenue continuing to lag. This has resulted in a widening financing gap. In the 10-year period to 2017, the total value of public expenditure increased from 15 percent of GDP to more than 20 percent. During this time, the tax-to-GDP ratio grew by an average annual rate of 0.2 percentage points, with the value of collected revenues increasing from 10 to 13.8 percent of GDP over the same period. By 2016, the value of Uganda's collected per capita revenues stood at US$ 211 of PPP adjusted to 2011 international dollars. This covered 66 percent of general government expenditures, with the remainder covered by loans and grants. The gap between revenues and expenditures could continue to increase into the future, with the expenditure increasing to meet the need to develop the stock of physical infrastructure and to raise the quality and quantity of social services to meet the needs of Uganda's rapidly expanding population.

With the Government currently formulating a new strategy to increase domestic revenues, this is an appropriate point to reassess previous approaches to revenwue collection. Over the past few years, Uganda has set a mid-term revenue target of 16 percent of GDP. However, it has been unable to meet this target, with many areas of economic activity remaining outside the tax net due to gaps in the areas of tax policy and administration. The new medium-term Domestic Revenue Mobilization Strategy (DRM-S) currently under preparation is critically important, most importantly because it offers a significant opportunity for Uganda to reboot its efforts to generate increased revenues and to improve the way in which these revenues are raised, in a manner consistent with the overall objectives of increased growth and equity. The efficient mobilization of domestic revenue, combined with the efficient use of financial resources, is also essential to strengthen the social contract between Uganda's government and the country's citizens.

However, it remains to be seen whether Uganda can increase its domestic revenues and, if so, how. This update argues that to improve performance in this area, avoiding policy discretion is just as important as extending the tax net through innovative approaches to collect revenues from hard-to-tax areas, particularly in the informal economy.


Money – Uganda's currency notes (World Bank / Sheila Kulubya, 2016)

External debt of GDP

26%

Domestic debt of GDP

14%

Part 1: State of the economy

After growing at 4 percent in FY2016/17, preliminary data suggests that real GDP in Uganda has risen 7.1 percent during the first half of FY 2017/18, compared to the same period in FY 2016/17. In fact, real output only grew 2.4 percent in the first half of FY 2016/17, when the economy was plagued by adverse weather conditions and pests such as the army worm. The recent growth recovery is largely driven by a double-digit increase in ICT services, strong food crops production, and the robust growth performance of the manufacturing sector.

Improved food supply supported the deceleration in core inflation to 3.2 percent during the first three quarters of FY 2017/18 from 5.2 percent a year ago, well within the Bank of Uganda's target (3 to 7 percent), allowing for a reduction in February of the policy rate to 9 percent. This is the fourth reduction since the rate reached a peak of 11.5 percent a year ago. The inflation deceleration was mainly due to a decline in sugar, bread and cereal prices. Despite the consecutive reductions of the policy rate, the cost of private sector credit remains relatively high and, subsequently, private sector credit growth remains subdued.

The rebound in output growth accelerated import volumes and widened the external current account deficit to 4.4 percent of GDP during the first half of FY 2017/18, including capital transfers, from 2.5 percent a year earlier. Non-oil private sector imports more than offset strong export growth of coffee, tea, maize and beans. This led to a widening of the merchandise trade deficit to 6.8 percent of GDP in the first half of FY 2017/18, compared to 6.5 percent of GDP the year before. Net travel and remittance inflows, meanwhile, have not performed as well as last year. Nevertheless, net government borrowing and FDI inflows exceeded the external shortfall. As a result, foreign exchange reserves increased to US$ 3.7 billion (or 5.3 months of imports of goods and services) in December 2017. The value of the shilling has remained relatively stable over the 12-month period since March 2017, depreciating around 1.5 percent in nominal terms, and 6 percent in real terms.

A good harvest makes Gina smile, Kapchorwa (Artfield Graphics 2017)

Improved food supply supported the deceleration in core inflation to 3.2 percent during the first three quarters of FY 2017/18 from 5.2 percent a year ago

Smaller capital spending offset a contraction in fiscal revenues leaving the central government cash deficit at 4.9 percent of GDP during the first half of FY 2017/18, roughly the same level compared to last year when the deficit amounted to 4.8 percent of GDP. Government revenues shrunk, in GDP terms, mainly due to a fall in grants, while tax collection was marginally below last year's outcomes. Thus, the Government is unlikely to achieve its goal of increasing tax revenues by 0.5 percent of GDP in FY 2017/18. The Government repaid 0.4 percent of GDP in arrears, double the amount compared to the same period last year. It appears, however, that at the same time, the stock of arrears is likely to have risen, in GDP terms.

Despite sizable fiscal gross financing needs averaging 11.5 percent of GDP over the past five years, Uganda's external risk of debt distress remains low. Total public debt stood at 40 percent of GDP, a level comparable to Uganda's peers in East Africa. Over the past four years, the authorities have switched the financing mix to rely more on foreign than domestic borrowing to meet the gross financing need. This shift in the financing mix meant faster growth in external public debt, which at the end of 2017 reached 26 percent of GDP, while domestic debt stabilized at around 14 percent of GDP. External financing is largely contracted on highly concessional terms, with long grace periods and long maturities, which reduces Uganda's debt burden in present value terms. The Government was prudent in avoiding international bond issuances over the past few years, when global interest rates were low. Therefore, the debt repayment profile is smooth, with no external principal repayment spikes that raise rollover risks, as in some other East African countries.

In FY 2017/18, real output is expected to grow at close to 5.5 percent and could reach 6 percent in FY 2018/19, assuming improved execution of capital spending, favorable weather conditions, and barring other external shocks. In the short term, weather-related shocks, pest infestations and delays in public investment execution may constrain real GDP growth. Real GDP growth could also be adversely impacted by an unexpected increase in oil prices or a sudden decline in foreign demand. Reduced foreign demand, which would weaken exports, can come in the form of further regional instability due to an escalation of conflict in South Sudan and the Democratic Republic of Congo (DRC), Uganda's second and fourth export destinations.

Strong output growth is expected to widen the current account deficit to about 5 percent of GDP in FY 2017/18 and 6 percent in FY 2018/19. Nevertheless, a pick-up in net FDI investment, as oil exports get nearer, would ensure a stronger buffer in terms of foreign exchange reserves.

Smaller capital spending offset a contraction in fiscal revenues leaving the central government cash deficit at 4.9 percent of GDP during the first half of FY 2017/18, roughly the same level compared to last year when the deficit amounted to 4.8 percent of GDP. Government revenues shrunk, in GDP terms, mainly due to a fall in grants, while tax collection was marginally below last year's outcomes.

Thus, the Government is unlikely to achieve its goal of increasing tax revenues by 0.5 percent of GDP in FY 2017/18. The Government repaid 0.4 percent of GDP in arrears, double the amount compared to the same period last year. It appears, however, that at the same time, the stock of arrears is likely to have risen, in GDP terms.

Weaker than planned tax collections will prevent the Government from meeting the 0.5 percent of GDP increase in FY 2017/18, as mandated by the Charter of Fiscal Responsibility. The overall fiscal cash deficit, including repayments of arrears, is likely to widen from 3.9 percent of GDP recorded last year to around 4.5 percent of GDP in FY 2017/18. This is still lower than the budgeted deficit of 6.2 percent of GDP presented in the Budget Framework Paper. At the same time, however, the stock of verified arrears could exceed 3 percent of GDP by the end of FY 2017/18.

The weaker tax collections this year demonstrates the limited progress made in the past, and raises the urgency of tax reforms. Comparing Uganda to economies with similar characteristics, it has the potential to collect revenues of about 20 percent of GDP or more over the medium term. Thus, Uganda needs a robust revenue strategy to finance much-needed capital and social safety spending, which will help promote economic growth and also safeguard fiscal sustainability. The expected oil revenues further raise the urgency of taking the opportunity now to increase tax revenues. Considering the wide-ranging benefits and urgency of tax reforms, the second chapter of this report discusses options for tax policy and tax administration, and recommends reforms that could put the tax-to-GDP ratio on an upward trajectory, so that Uganda reaches its growth potential.

Part 2: Special topic: Financing growth and development: Uganda must raise more domestic revenues

Uganda's revenue collection performance has improved over recent years, with its revenue-to-GDP ratio reaching almost 14 percent of GDP. While this is significantly better than the average ratio of 11 percent that it recorded in the recent decade, it is still lower than that of regional peers and short of the Government's own target. In the period from 1993 to 2013, the tax-to-GDP ratio grew by the average annual rate of 0.2 percentage points, increasing the value of collected taxes from 7.6 percent to 11.6 percent of GDP. Non-tax revenues added another 0.2 percent of GDP. By FY 2016/17, the ratio had increased to around 14 percent, with the improvement attributable to the impact of new policy initiatives to expand the tax net and to more effectively collect non-tax revenues, as well as efforts to improve compliance. However, with the failure to sustain some of these efforts, in more recent years, there have been significant shortfalls. In FY 2017/18, the ratio is expected to reach about 13.5 percent. This is significantly lower than the mid-term revenue target of 16 percent of GDP established some time ago, and lower than that recorded by regional peers.

In FY 2017/18, real output is expected to grow at over 5 percent and could reach 6 percent in FY 2018/19, assuming improved execution of capital spending, favorable weather conditions, and barring other external shocks. In the short term, weather-related shocks, pest infestations and delays in public investment execution may constrain real GDP growth.

Real GDP growth could also be adversely impacted by an unexpected increase in oil prices or a sudden decline in foreign demand. Reduced foreign demand, which would weaken exports, can come in the form of further regional instability due to an escalation of conflict in South Sudan and the Democratic Republic of Congo (DRC), Uganda's second and fourth export destinations.

In 2016, Kenya's tax-to-GDP ratio stood at around 18 percent; Rwanda's at 16 percent; and Tanzania's at around 14.5 percent. Uganda's ratio is also below the COMESA and Sub-Saharan average more generally.

The tax revenue system has been negatively affected by application of tax exemptions, growing informality, and diminishing political support for tax collection efforts. Revenue forgone under the current tax system across all tax sources due to exemptions was estimated to be in the range of 4.5 to 5.0 percent of GDP in 2016/17.[1] This can be explained by several factors. First, policy discretion, mainly in the form of tax exemptions, had a significant impact in the period from 2006 to 2016, as measured by the differential between tax buoyancy[2] and tax elasticity.[3] Second, the shift in the composition of the economy from agriculture to services and industry has strengthened the informal sector, with those leaving agriculture tending to end up in small informal non-agricultural enterprises. According to UBOS, informal activities account for 45 percent of GDP. Those involved in these activities are hard-to-reach tax payers, conducting most of their transactions in cash and/or hiding their economic activities from tax authorities. Finally, current policy messages have resulted in a perception that Uganda needs investors, but not revenue. Some income categories are exempted from taxation, with this benefiting privileged groups and creating perceptions of unfairness. The social contract remains weak, due to poor service delivery.

The VAT is the most important source of revenues, generating revenues to a value of around 4 percent of GDP. However, this category of tax is also subject to the most significant losses due to exceptions, amounting to a value of around 2.5 percent of GDP. In FY 2016/17, roughly half of the 4 to 5 percent of GDP tax losses were attributable to VAT exemptions. Practices such as carrying forward offsets, allowing concessions on zero-rating for domestic supplies, VAT exemptions, mal-implementation of the VAT refund system, and deemed VAT provisions, are all eroding the VAT tax base. As a result, Uganda's performance in the collection of VAT remains consistently poorer than Kenya's, Tanzania's and Rwanda's.

A key reform to the VAT system would involve the establishment of a Tax Expenditure Governance Framework to help manage tax exceptions. The framework would include rules related to tax expenditures to assess the efficiency, impact and equity of tax exemptions, and to remove them if warranted. The framework should: (i) include a clause that refrains

1 Tax expenditures represent the cost to the economy resulting from exemptions or deviations or concessions from a regular tax (VAT, CIT or Excise) system. These have been computed using the revenue foregone method.

2 Tax buoyancy measures the responsiveness of taxes collected to the change in GDP.

3 Tax elasticity also measure responsiveness of taxes collected to the change in GDP (as tax buoyancy), but excludes the impact of policy changes on taxes collected

Money: United States of America dollar (World Bank / Morgan Mbabazi, 2016)

Over the past four years, the authorities have switched the financing mix to rely more on foreign than domestic borrowing to meet the gross financing need. This shift in the financing mix meant faster growth in external public debt, which at the end of 2017 reached 26 percent of GDP

any authority from granting discretionary exemptions in whatever form; (ii) subject each new exemption or VAT zero rating to an extensive cost/benefit analysis; (iii) evaluate existing VAT exemptions to determine whether they remain relevant, with the release of the associated analysis to ensure greater transparency; and (iv) if feasible, establish a ceiling on VAT exemptions, with the publication of reports on the degree to which compliance with this ceiling is achieved. The establishment of this framework and the promulgation of the associated fiscal rules could reduce the number of exemptions and thus increase the total value of collected VAT.

The value of collected excise duties amounts to around 2.5 percent of GDP, a decline from the figure of 3.5 percent recorded in the 1990s, with the value of forgone revenues within this system estimated to stand at about 0.5 percent of GDP. Preferential excise rates charged on beers, cigarettes, spirits and wines, and exemptions for automobiles and aviation taxes have been the main sources of leakages. Product-specific challenges range from definitional distortions to loss of value through inflation. In terms of policy, the introduction of a system of price indexation of specific rates to preserve value against inflation could be followed by streamlining product-specific excise duty policies, including: (i) creating a single tier tax rate structure for all cigarettes to ensure that all forms of cigarettes are covered by the excise regime, with the implementation of Track and Trace Systems to curb tax evasion; (ii) applying alcohol tax rates on alcohol content, rather than the current approach with which rates are based on the raw materials used to produce alcohol products; and (iii) broadening the classification and definition of non-alcoholic beverages. In the medium term, petroleum excise duty coverage could be reviewed to confirm that aviation or jet fuel importers on the exemption list meeting the requirements for this exemption. Also, imposing excise tax rates that factor in the energy content in fuels and that includes residual oils, medium oils and preparations in the excise tax base, would follow good international practice.

The corporate income tax generates revenues to a value of about 2 percent of GDP, but is constrained by tax reliefs in the form of incentives and generous depreciation rules, which together result in forgone revenues to a value of about 1 to 2 percent of GDP. In the period from 2014 to 2016, CIT revenue foregone was estimated to have declined from 1.9 to 0.2 percentage points of GDP, due to exemptions alone. However, the reforms implemented in 2017 could reverse the gain made. In

Goods verification in a warehouse in Nakawa (World Bank / Morgan Mbabazi, 2016)

Uganda's revenue collection performance has improved over recent years, with its revenue-to-GDP ratio reaching almost 14 percent of GDP, better than the average ratio of 11 percent but still lower than that of regional peers

addition, 'other' allowable deductions and the lack of thin capitalization rules for domestic companies reduces taxable income, thus eroding the tax base. The perpetual loss-carry-forward policy has resulted in the potential deferral of CIT tax payments worth 3 percent of GDP. Estimates suggest that the effective CIT rate on net chargeable income has consistently been negative, at an average of 14 percent over the last four years, whereas the nominal tax rate is 30 percent. To raise additional revenues from the business sector, the Government should review the current system of tax reliefs and incentives and retain only those that address market failures. The development of a Tax Expenditure Fiscal Governance Framework would be beneficial to guide the process of assessing the efficiency of tax exemptions and to identify those that should be abolished. It would also provide a solid basis for the assessment of new tax exemptions.

There is also scope to increase the efficiency of the tax administration. This could be achieved through the improved computerization of URA's operations, the maintenance of a clean tax register to improve accuracy and confidence in the tax system, and the development of the appropriate capacities amongst staff of the URA. In the short term, the priority for capacity building should be to close gaps in core functions such as data analysis and forecasting, auditing and the investigative functions. This should be followed with a strategic plan to build and maintain the required capacities across all policy and administrative functions across all DRM institutions, in the medium and long term.

To support the reforms, the authorities should formulate and implement strategies that promote a culture of compliance with the tax system, including through high-level political messaging. In addition to developing a culture of compliance amongst ordinary taxpayers, political leaders must make a deliberate effort to conduct a campaign that raises public awareness of the importance of taxation for Uganda's development. It should implement measures to improve perceptions of fairness by minimizing exemptions, as these perceptions play an important role in the establishment of a culture of compliance with the tax system.

The Government could improve transparency and accountability by establishing clearer linkages between taxation and public expenditure and by ensuring that tax administration and enforcement was implemented more equitably. In addition to the annual URA revenue report, the Government could prepare and publicize a report on revenue by geographic area and link these to valuable expenditure outcomes. The URA has invested heavily in taxpayer services by establishing a taxpayer services division, the main task of which is to offer taxpayer services, including assistance, information, education, and outreach services. This division runs a call center, while URA provides online self-services to taxpayers through the e-Tax system.

These reforms could contribute significantly to the formulation of an effective Domestic Revenue Mobilization Medium-Term Revenue Strategy (DRMTS). In the preparation of the DRMTS, the authorities core aim is to expand the tax base to increase the tax to GDP ratio, while establishing a transparent, equitable and fair tax system that ensures that per capita tax liabilities match the income profiles of the taxpayers and that the Government is accountable for the use of revenues. The DRMTS creates an opportunity for the Government and the broader public to establish a new social contract based on a sense of mutual responsibility, with the rights and obligations of all parties clearly defined.

Revenue forgone due to VAT exemptions

4.5%

Value of collected excise duties

2.5%

Transporters waiting for customs clearance in Malaba (World Bank / Sheil Gashishiri, 2015)

In the preparation of the Domestic Revenue Mobilization Medium-Term Revenue Strategy, the authorities core aim is to expand the tax base to increase the tax to GDP ratio

PART 1

STATE OF THE ECONOMY

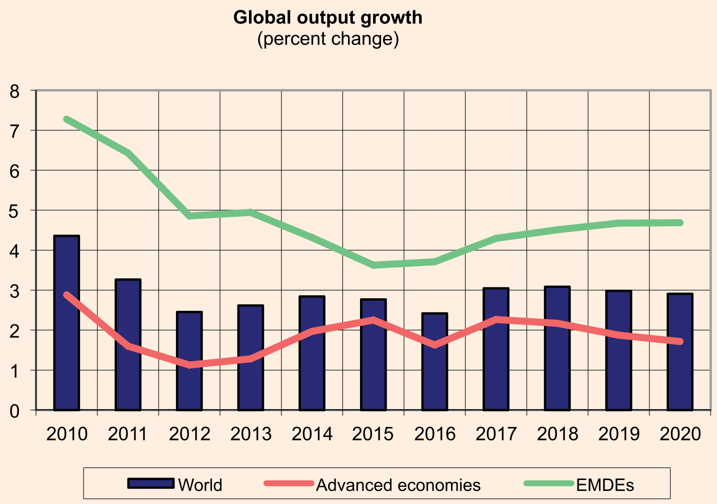
A typical business scene at Kikuubo market in Kampala (World Bank / Morgan Mbabazi, 2018)

01 RECENT ECONOMIC DEVELOPMENTS

1.1 The global economy continues strengthening[4]

Supported by improved confidence, accommodative polices, and a rebound in investment, commodity prices and trade, global output growth is recovering (Figure 1). While the recovery in the US is investment-led, better output growth in the Euro Area is being driven primarily by trade. Thus, policies will likely start shifting from supporting domestic demand to structural reforms that boost potential growth and productivity. Higher global growth rates are expected to be sustained over the medium term, especially in commodity exporters. However, downside risks remain substantial and relate to stress in financial markets, increased trade protectionism, and rising geopolitical tensions.

Figure 1: Global output growth has strengthened



Source: Global Economic Prospect, World Bank, 2018

Notes: EMDEs = emerging market and developing economies. Aggregate Growth rates calculated using constant 2010 U.S. dollar GDP weights.

Growth accelerated in all major economies, including better than expected growth in the Euro Area, and in most emerging markets and developing economies (EMDEs). With real GDP growing at 2.4 percent, the Euro Area gained momentum in 2017 spurred by external demand and policy stimulus. The latter reflects the European Central Bank's asset purchase program that has stimulated private credit growth, which in turn supported growth in domestic demand. Labor markets tightened in response, as unemployment

4 The Global Economy section is based on the World Bank's Global Economic Prospects (GEP), January 2018

rates dropped to levels last seen in 2009. Investment-led growth in the US picked up in 2017 to an estimated 2.3 percent. As a result, the US economy moved closer to full employment, and the Federal Reserve continued to normalize monetary policy, raising interest rates and starting to reduce gradually the size of its balance sheet. In Japan, real GDP grew 1.7 percent, supported by a fiscal stimulus package and a gradual recovery in consumer spending and investment. As in the Euro Area and the US, labor markets tightened, and the unemployment rate fell to a 22-year low. Despite a recovery in output growth, inflation rates remain relatively low across all major economies. Output growth in China, meanwhile, reached 6.8 percent, driven by fiscal support and net exports. Chinese growth is expected to decelerate to about 6 percent over the medium term, as the drivers of growth shift from investment and exports to domestic consumption.

Output growth in Sub-Saharan Africa is estimated to have picked up to 2.6 percent in 2017 from 1.5 percent in 2016. This increase is based on the modest recovery in Africa's largest economies: Angola, Nigeria, and South Africa. The recovery was driven by favorable global financial conditions and, to some extent, by the modest rise in commodity prices. That said, oil exporters across the region continue dealing with the effects of the oil price collapse, and public debt-to-GDP trajectories continue rising. For example, Chad, Congo Republic, and Equatorial Guinea all recorded negative growth rates in 2017, while growth rates in Cameroon and Gabon declined by roughly 1 percentage point compared to the previous year. At the same time, non-resource countries have expanded at a solid pace, with Senegal and Cote d'Ivoire growing at around 7 percent.

In East Africa, Ethiopia, Rwanda, and Tanzania exhibited the highest growth rates in 2017, ranging between 6.1 and 10.3 percent. In Kenya, poor rains led to a decrease in real growth to 4.9 percent of GDP, which caused a contraction in agriculture output and also reduced hydropower generation. Domestic demand was further dampened by a decline in private sector credit growth and election-related uncertainty.

In East Africa, Ethiopia, Rwanda, and Tanzania exhibited the highest growth rates in 2017, ranging between 6.1 and 10.3 percent.

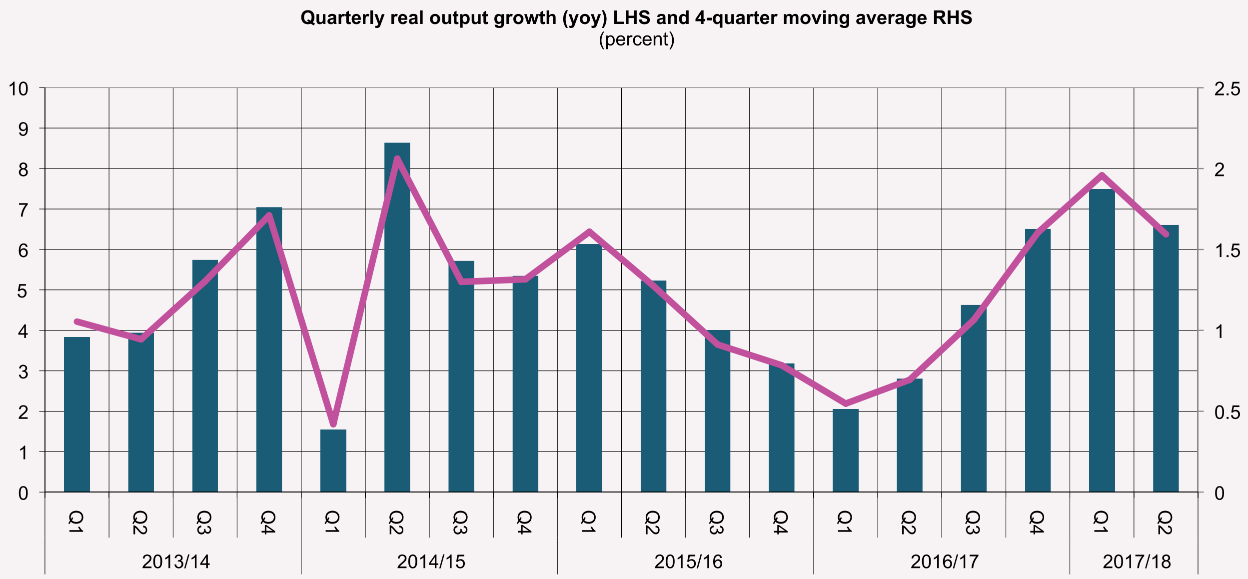
In the meantime, two of Uganda's main trading partners, the Democratic Republic of Congo (DRC) and South Sudan, exhibited weak growth performance. Although real GDP in DRC is estimated to have grown 3.4 percent in 2017, after slowing to 2.4 percent in 2016, this moderate recovery remains fragile. Uncertainties related to the elections scheduled for the end of 2018 hamper investment in all sectors, and delay development partners' decisions to scale up their financing. In South Sudan, the economic collapse continued, following two years of double-digit negative growth rates due to conflict, disruptions to oil production, and weak agriculture production. The situation in both countries has negative implications for Uganda's export prospects in FY 2017/18 and beyond.

Output growth in Uganda bounced back strongly

> real GDP in Uganda has risen to
> ↑ 7.1%
>
> In Kenya poor rains led to a decrease in real growth to
> ↓ 4.9%

After growing at 4 percent in FY 2016/17, preliminary data suggests that real GDP in Uganda has risen 7.1 percent during the first half of FY 2017/18, compared to the same period in FY 2016/17. Real output growth amounted to 7.5 and 6.6 percent (yoy) during the first two quarters in FY 2017/18, respectively, building on the recovery underway since the second quarter of FY 2016/17 (Figure 2). The strong growth outcome during the first half of FY 2017/18 compares to 2.4 percent output growth during the same period last year, which was plagued by adverse weather conditions and infestations such as the army worm. Interestingly, from a calendar year perspective -- a measure used by most countries worldwide -- real GDP growth in Uganda in 2017 has more than tripled to 7.6 percent compared to only 2.5 percent in 2016. This strong rebound would place Uganda among the top growth performers in East Africa, based on a calendar year measure. The weak real GDP growth outcome in calendar year 2016 in Uganda is evidence of the economy's dependence on rain-fed agriculture, and untapped large potentials that are grounded in the country's diverse agro-ecological zones, comparably low temperature variability, and two rainy seasons in most parts of the country.

Figure 2: Real GDP growth rebounds in Uganda



Source: Uganda Bureau of Statistics (UBOS)

Beans (Artfield Graphics 2017)

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Strong growth during the first half of FY 2017/18 was largely driven by an increase in services and agriculture output

Strong growth during the first half of FY 2017/18 was largely driven by an increase in services and agriculture output (Table 1). Output in the services sector accelerated to close to 9 percent supported by another year of double digit growth in ICT. The latter rose over 15 percent in the first half of FY 2017/18 (yoy), after growing 14 percent in FY 2016/17. Favorable weather conditions, meanwhile, led to the sizable pick-up in overall agriculture output of 6.3 percent, spurred by a 9.5 percent increase in food crops production. This remarkable recovery can be in part explained by the low base in the first half of FY 2016/17, when food crop production dropped 4 percent, largely due to drought and pests. In contrast to the impressive performance of food crops, the production of cash crops declined by 3 percent in the first half of FY 2017/18 compared to the same period last year. Forestry output grew 6.6 percent during the first half of FY 2017/18, while livestock production grew 2.6 percent, compared to 1.5 percent a year ago during the same period.

In addition to ICT, growth in the services sector was supported by trade and financial/insurance services. With larger export and import flows, trade services grew 7.6 percent in the first half of FY 2017/18, while financial and insurance services rose 12 percent (yoy), a sign that the insurance market is gaining momentum. At the same time, sustained strong construction activity, which largely relies on government projects, supported the robust growth in real estate services amounting to 6.3 percent (compared to 5.5 percent a year ago).

Industrial output grew 6.4 percent (yoy) during the first half of FY 2017/18, after growing 3.3 percent in FY 2016/17. This acceleration

Table 1: Evolution of output growth and prices

Output and inflation (percent change)				H1 (July - Dec)	
	2014/15	2015/16	2016/17	2016/17	2017/18
Real GDP (2009/10 prices)	**5.2**	**4.7**	**4.0**	**2.4**	**7.1**
Agriculture, forestry and fishing	2.3	2.8	1.6	-1.9	6.3
Industry	7.8	4.6	3.3	4.2	6.4
Services	4.8	5.9	5.7	3.8	8.8
Memoranda:					
Exports of goods, total (value, yoy % chg)	1.2	-1.8	17.7	18.2	11.6
Imports of goods, w/o freight and insurance (value, yoy % chg)	-1.7	-8.3	3.1	-6.0	13.5
Nominal effective exchange rate (yoy % chg)	6.4	12.7	0.8	-1.8	2.4
Consumer prices (average)	2.9	6.5	5.7	4.8	4.7
Consumer prices (end-perod)	4.9	5.9	6.4	5.7	3.3

Source: UBOS and BoU

in industrial output exceeds significantly the growth rate of around 4 percent recorded during the first half of last year, and 5 percent the year before. Manufacturing accounts for more than one-third of growth in industry output, and has expanded 5.4 percent during the first half of FY 2017/18. Construction, meanwhile, grew 4.8 percent, based largely on government projects.

"

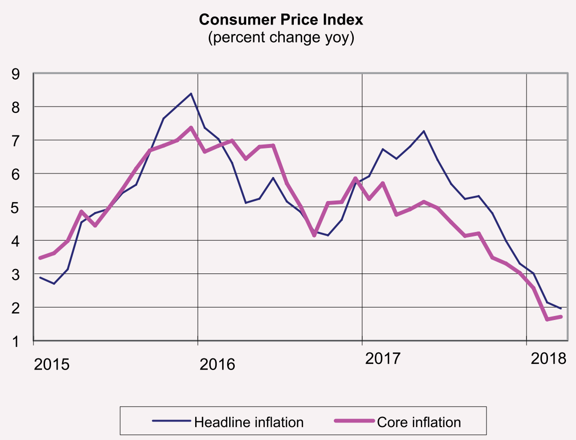
The deceleration in headline inflation was supported by deflation in food crop prices due to improved supply

1.2 Headline inflation and core inflation continue decelerating

Core inflation continued decelerating, and stood at 1.7 percent in March 2018 (yoy), allowing for a reduction in the policy rate to 9 percent (Figure 3). Overall, core inflation averaged 3.2 percent during the first three quarters of FY 2017/18, which lies within the central bank's target range of 3 to 7 percent. In response to this downward trajectory, Bank of Uganda lowered the policy rate in February, the fourth reduction in the policy rate since it reached its peak of 11.5 percent a year ago. The deceleration in core inflation was mainly due to lower sugar, bread and cereal prices.

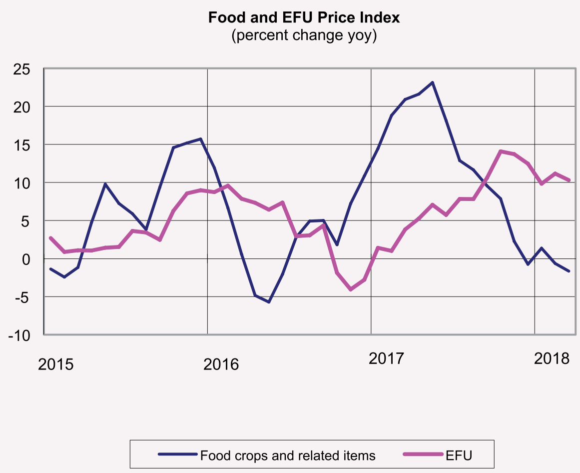
Headline inflation more than halved to 2 percent in March 2018, from its recent peak of 7 percent in May 2017, due to a significant slowdown in food prices (Figure 3). The deceleration in headline inflation was supported by deflation in food crop prices (-1.6 percent) in March (yoy) due to improved supply, particularly of fruits and vegetables. In other words, during the first three quarters of FY 2017/18 (July to March), food crop prices have grown on average only 4.4 percent, compared to 9.6 percent during the same period last year. Recent deflationary pressures in food crop prices were in part offset by a sharp increase in charcoal and firewood prices, which rose

Figure 3: Inflation rates decelerate



Source: Bank of Uganda

Figure 4: Easing of food, energy, fuel, and utility prices



Source: Bank of Uganda

> Commercial banks maintain high net interest margins, attributed to high overhead costs, costs of conducting due diligence and costs associated with the expansion of branches to rural areas

16.8 percent in March 2018. In Uganda, charcoal and firewood are used by around 90 percent of households for cooking. This spike in prices was the main driver of the marked increase in the growth of Energy, Fuel and Utilities (EFU) prices to 14.1 percent in October 2017 (yoy). Furthermore, an acceleration in liquid energy fuels (petrol, diesel, and kerosene) to 8.7 percent has played an important role in EFU price increases recently, as global oil prices continue rising. Specifically, the Brent spot price rose from a low in June 2017 of US$ 46 per barrel to US$ 64 per barrel in March 2018,[5] with spillover effects on retail pump prices in Uganda. Nevertheless, EFU price pressures have eased, with the rate declining from a peak of 14 percent in October 2017 to 10.3 percent in March 2018 (Figure 4).

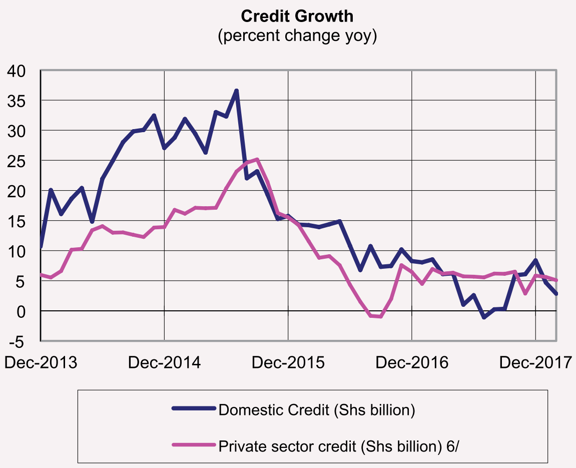
1.3 Despite a drop in the policy rate, private sector lending remains subdued

Domestic credit growth averaged around 3.5 percent (yoy) during the first eight months of FY 2017/18, which is a deceleration compared to the 8.5 percent growth rate recorded during the same period last year. This outcome is a combination of steady growth in private sector credit, and a reduction in the growth of net credit to government due to a shift in the financing mix toward external borrowing. Private sector credit growth averaged around 5.5 percent during the first eight months of FY 2017/18 (yoy), and remained stagnant despite the reductions to the policy rate of 2.5 percentage points over the past 12 months.

The cost of private credit remains relatively high. The weighted average lending rate of commercial banks in domestic currency declined to 21 percent in February 2018, after reaching a peak of 25 percent

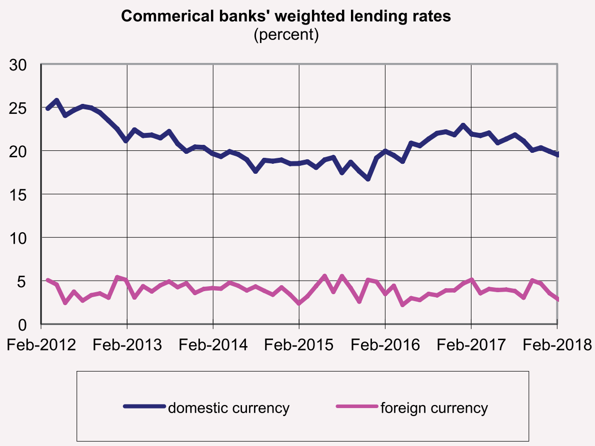
5 www.eia.gov

Figure 5: Private credit growth remains subdued



Source: Bank of Uganda

Figure 6: Weighted average lending rates are declining



Source: Bank of Uganda

two years ago (Figure 6). Lending rates in foreign currency follow a similar trend, and fell from over 10 percent to 7.2 percent in February 2018. Meanwhile, deposit rates (on savings in shillings) have also declined, from close to 5 percent in July 2016 to around 3 percent in February 2018. Thus, commercial banks maintain high net interest margins. These high margins are attributed to high overhead costs, high costs of conducting due diligence, and high costs associated with the expansion of branches in rural areas.[6] Uganda's ratio of overhead costs to total assets appears to be the second highest in the EAC (after Rwanda), and much higher than international levels. Salaries constituted the largest share of overhead costs in Uganda due to the scarcity of qualified professionals, which also hampers financial innovation in the financial sector. Banks in Uganda have a limited number of large customers, and the cost of conducting due diligence on small and medium enterprises is high.

> Measures to improve public financial management to prevent the build-up of arrears would benefit the financial sector

Non-performing loans (NPLs) are contracting, but have not yet reached the levels seen in 2015. NPLs-to-total gross loans have contracted from a peak of 10.5 percent in December 2016 to 5.6 percent in December 2017, which is still above the level of 4 percent recorded in 2015. In this context, the build-up of government arrears is not conducive to reducing NPLs. Thus, measures to improve public financial management to prevent the build-up of arrears would benefit the financial sector. Furthermore, enhancing the coverage of the credit reporting system through credit bureaus would also support private sector credit growth, in addition to other structural measures. According to the Doing Business 2018 report, only 6 percent of the population in Uganda is covered by the credit reporting system. In Kenya, the population coverage is 30 percent, in Rwanda it is close to 20 percent, while in Malawi population coverage is around 24 percent.[7]

6 See World Bank (2015) Uganda – Financial Sector Review, June
7 See www.doingbusiness.org

1.5 The external position has deteriorated, driven by strong demand for imports to support the rebound in output growth

The external current account deficit rose to 4.4 percent of GDP during the first half of FY 2017/18, including capital transfers, from 2.5 percent during the same period a year earlier (Table 2). The jump in export volumes, particularly of coffee (32 percent), was more than offset by an acceleration in import volumes. Driven by the recovery in economic activity, non-oil imports have risen around 10.5 percent, while oil imports increased 10 percent. As a result, the merchandise trade deficit widened to 6.8 percent of GDP, which is 0.5 percentage points larger compared to the deficit recorded during the same period last year (Table 2). The improvement in terms of trade of close to 4 percent has helped limit the widening of the merchandise trade deficit.[8] In addition to a wider deficit in the trade of goods, the traditionally positive balance from net services, income, and transfers flows has narrowed by 1.1 percentage points to 1.9 percent of GDP, compared to the same period last year. The resulting external shortfall of 4.4 percent of GDP, including capital transfers, was largely financed by non-debt creating net FDI inflows, which amounted to 2.5 percent of GDP (or US$ 363 million).


Ripe coffee beans ready for harvest (Artfield Graphics 2017)

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Export of goods rose 12 percent during the first half of FY 2017/18, driven by coffee and tea exports

Export of goods rose 12 percent during the first half of FY 2017/18, driven by coffee and tea exports. Aided by improved terms of trade, exports of goods increased by US$ 175 million to around US$ 1.7 billion during the first half of FY 2017/18. The value of coffee and tea exports expanded by 33 percent, while exports of maize grew 50 percent and beans 145 percent. Together, these four commodities accounted for one-fourth of total exports in the first half of FY 2017/18. The decline in gold exports (13 percent), which alone represents one-tenth of total exports, and tobacco (2 percent) offset in part the good export performance.

Imports, meanwhile, grew 13.5 percent to US$2.7 billion in the first half of FY 2017/18 from US$2.3 billion a year ago, largely due to private sector imports that expanded at a rate close to 17 percent. Total private sector imports rose by US$ 400 million to US$ 2.4 billion, of which oil imports alone accounted for US$ 100 million, an increase of 32 percent yoy, largely due to higher global oil prices. Non-oil imports increased 16 percent to US$ 1.8 billion, mostly due to larger imports of chemical products (28 percent); non-durable consumption goods, such as vegetable products, fats and oil (16 percent); and durable consumption and investment goods, such as machinery and vehicles (20 percent). In parallel, imports for government projects continued to decline gradually after reaching a peak of US$ 340 million in FY15/16, to US$ 270 million in FY 2016/17 and to US$ 255 million in the first half of FY 2017/18. This decline is largely due to the completion of three-fourths of the

8 Export prices rose 8.7 percent, while import prices increased 4.7 percent in the first half of FY 2017/18 compared to the same period last year.

Table 2: The current account balance

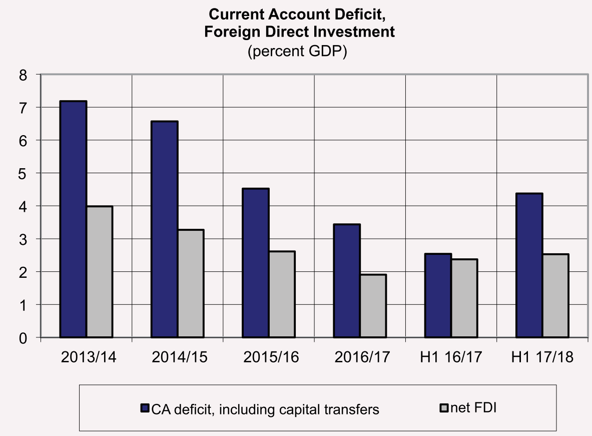
Current Account Balance (millions of dollars)	2015/16	2016/17	H1 (July - Dec) 2016/17	2017/18
Merchandise trade	**-1887**	**-1555**	**-831**	**-974**
(% GDP)	(-7.8)	(-6.0)	(-6.3)	(-6.8)
	-	-	-	-
Exports	2688	3164	1515	1690
Imports	4574	4718	2346	2664
Services, income and transfers, net	**678**	**515**	**401**	**278**
(% GDP)	(2.8)	(2.0)	(3.0)	(1.9)
(Travel earnings, net)	853	763	431	369
(Transport earnings, net)	-871	-901	-451	-531
(Personal transfers/remittances)	950	1183	690	642
(Government interest payments)	47	77	32	47
Current account balance	-1209	-1040	-430	-696
(% GDP)	(-5.0)	(-4.0)	(-3.3)	(-4.8)
Current account balance, including capital transfers	-1089	-889	-335	-628
	(-4.5)	(-3.4)	(-2.5)	(-4.4)
Current account balance, including capital transfers and NEO	**-938**	**-647**	**-421**	**-513**
(% GDP)	(-3.9)	(-2.5)	(-3.2)	(-3.6)
net FDI inflows	629	494	313	363
(% GDP)	(2.6)	(1.9)	(2.4)	(2.5)
Memoranda:	**(percent change)**			
Terms of Trade	5.3	0.0	-0.2	3.9
Real effective exchange rate	8.6	-0.6	4.4	5.5
GDP, nominal (in millions of dollars)	**24079**	**25881**	**13181**	**14361**

Source: Bank of Uganda

Isimba and Karuma dams, as well as a general contraction in government capital spending to 3.6 percent of GDP in the first half of FY 2017/18 from 4.9 percent of GDP during the same period a year earlier.

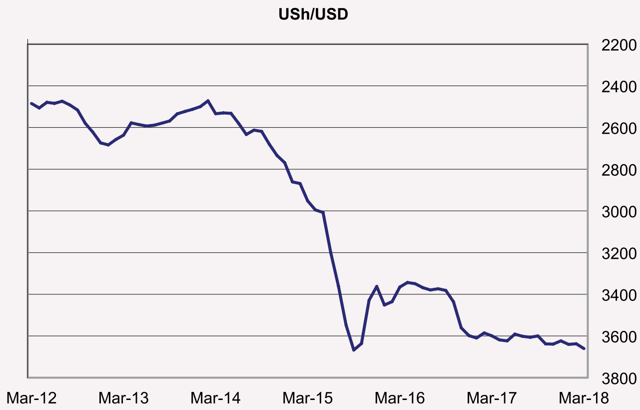
Smaller tourism revenues and remittances compared to last year narrowed the surplus on the services and incomes accounts to 1.9 percent of GDP in the first half of FY 2017/18 from 3 percent of GDP a year ago. Taken together, net travel earnings and remittances shrunk US$110 million compared to the previous year, which implies smaller foreign exchange inflows on the order of 1.5 percent of GDP. Net transport outflows increased by US$ 80 million, or 0.3 percent of GDP. At the same time, the Government paid close to US$50 million in interest on external loans during the first half of FY 2017/18, an increase of 47 percent compared to the same period a year ago.

Figure 7: Current Account Deficit and net FDI



Source: UBOS

Figure 8: Relatively stable nominal exchange rate



Source: Bank of Uganda

Debt and non-debt creating flows exceeded the current account deficit, resulting in a build-up of foreign exchange reserve on the order of US$215 million during the first half of FY 2017/18. Net foreign direct investments (FDI) stood at 2.5 percent of GDP (or US$ 363 million), of which US$ 154 million (or 1.1 percent of GDP) was direct equity; US$ 102 million (or 0.7 percent) was reinvested earnings; and US$ 107 million (0.7 percent of GDP) represented loans from parent companies to their subsidiaries in the form of intercompany loans (Figure 7). The Government borrowed externally 4.2 percent of GDP (or close to US$607 million), in gross terms, of which 93 percent was project-related and the remaining 7 percent for budget support. The Government repaid US$ 98 million in principal during this period (or 0.7 percent of GDP), twice as much as the year before. This brought the external debt stock (public and private) to US$ 6.9 billion at the end of December 2017, an increase of US$ 1.5 billion relative to the debt stock at the end of December 2016. Net external financing and FDI inflows bolstered foreign exchange reserves rose, which amounted to US$ 3.7 billion at end-December 2017 compared to US$ 3 billion a year ago. This is equivalent to 5.3 months (as calculated by the Bank of Uganda), which represents a robust buffer.

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the value of the shilling relative to the US dollar appreciated 9 percent in July 2016 to UGX 3,379 per dollar. Since then, the shilling depreciated to around UGX 3,600 per dollar

The value of the shilling has remained relatively stable during the 12-month period (Figure 8). After a cumulative depreciation of 48 percent from February 2014 to September 2015, the value of the shilling relative to the US dollar appreciated 9 percent in July 2016 to UGX 3,379 per dollar. Since then, the shilling depreciated to around UGX 3,600 per dollar, trading in a narrow band between Ush 3,620 and UGX 3,640 and from October 2017 to February 2018 traded in a narrow band ranging between UGX 3,620 and UGX 3,640.

Table 3: Government finances

Central Government Cash Balance (billions of Shillings)			H1 (July-Dec)	
	2015/16	2016/17	2016/17	2017/18
Revenues	12647	13897	6702	7347
(% GDP)	(15.3)	(15.2)	(14.7)	(14.1)
Tax revenues	11181	12593	5968	6701
(% GDP)	(13.5)	(13.8)	(13.1)	(12.9)
Grants	1147	950	582	422
(% GDP)	(1.4)	(1.0)	(1.3)	(0.8)
Expenditures	15075	16712	8238	8734
(% GDP)	(18.2)	(18.3)	(18.1)	(16.8)
Interest payments	1682	2360	1190	1179
(% GDP)	(2.0)	(2.6)	(2.6)	(2.3)
Capital expenditures	3508	4579	2225	1889
(% GDP)	(4.2)	(5.0)	(4.9)	(3.6)
Overall balance, incl. arrears payments	-4080	-3541	-2183	-2551
(% GDP)	(-4.9)	(-3.9)	(-4.8)	(-4.9)
Arrears repayments	119	184	106	225
(% GDP)	(0.1)	(0.2)	(0.2)	(0.4)
Memoranda:				
Primary balance, incl. arrears payments	-2398	-1181	-993	-1372
(% GDP)	(-2.9)	(-1.3)	(-2.2)	(-2.6)
3-month T-bill yields, average (annualized)	17.8	13.2	14.6	9.4
GDP, nominal (in billions of shillings)	**82903**	**91351**	**45539**	**51958**

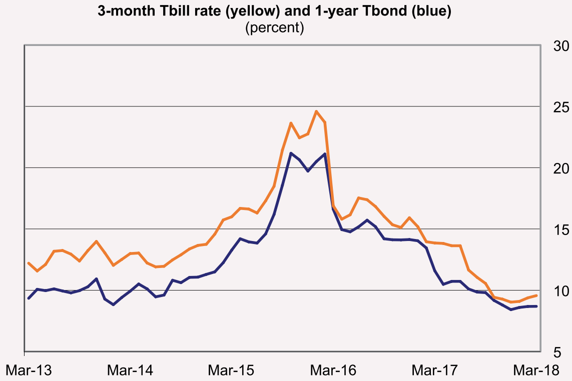
Source: MoFPED

1.6 Under-execution of the capital budget left the fiscal cash deficit at the same level as last year

Smaller capital spending offset a contraction in fiscal revenues resulting in an overall cash deficit, including arrears repayments, of 4.9 percent of GDP, broadly at the same level as last year, when the deficit amounted to 4.8 percent of GDP (Table 3). During the first half of FY 2017/18, total revenues declined by about 0.6 percent points to 14.1 percent of GDP compared to the same period last year, when total revenues stood at 14.7 percent of GDP. The decline was mainly due to a sharp contraction in grants, amounting to 0.5 percent of GDP, while tax revenues were only marginally smaller compared to the same period last year. Total expenditures, meanwhile, shrunk 1.3 percentage points to 16.8 percent of GDP compared to the same period last year. Smaller total spending is the result of falling capital expenditures (by 1.2 percent of GDP) and smaller interest payments (by 0.3 percent of GDP), while larger repayments of arrears (0.2 percent of GDP) was an offsetting factor. At the same time, the primary deficit[9], which excludes interest payments, has widened to 2.6 percent of GDP during the first half of FY 2017/18, from 2.2 percent of GDP a year ago.

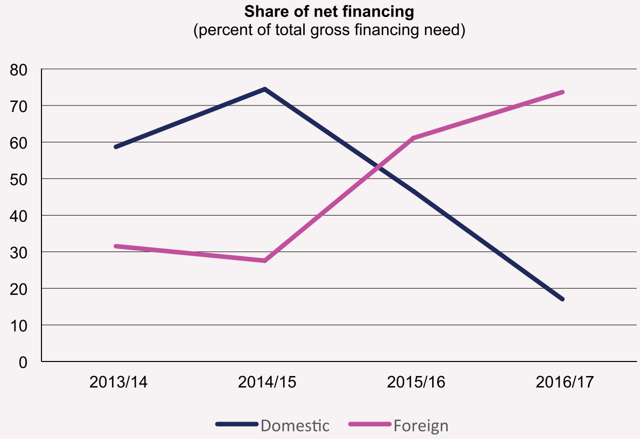
9 This figure has been adjusted for arrears repayments

Figure 9: Interest rate development on T-bills and T-bonds



Source: Bank of Uganda

Figure 10: Borrowing requirement increasingly met by foreign debt



Source: MoFPED

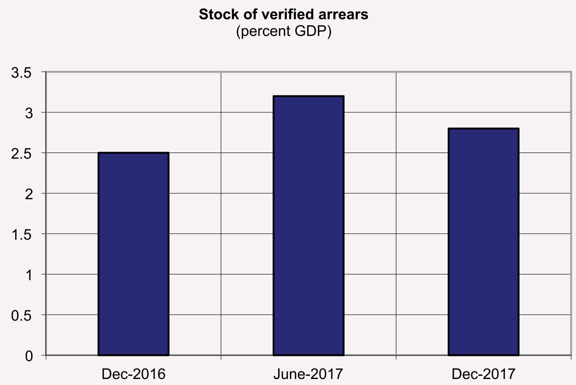
With tax collections at 12.9 percent of GDP in the first half of FY 2017/18, the Government is not on course to increase tax revenues by 0.5 percent of GDP during the fiscal year as planned. Tax revenues declined 0.2 percent of GDP compared to the first half in FY 2016/17 mainly due to lower collections of tax on interest income and corporate income, VAT on local goods, and excise duties on imports. Together, this shortfall amounts to roughly 0.5 percent of GDP. This was in part offset by better collections in withholding taxes and VAT on services, which together accounted for 0.3 percent of GDP. Grants have dropped 0.5 percent of GDP due to smaller project but also budget support compared to last year.

> Tax revenues declined 0.2 percent of GDP compared to the first half in FY 2016/17 mainly due to lower collections of tax on interest income and corporate income

The decline in total government spending is accounted for by smaller capital (development) spending, while current spending has remained constant, in GDP terms during the first half of FY 2017/18, when compared to the same period a year ago. The execution of domestic development spending is 0.4 percent of GDP smaller than last year, while external development execution contracted 0.9 percent of GDP compared to the same period last year. Counter-party financing seems to represent one of the important obstacles in executing capital spending. Current spending stood at 13.2 percent of GDP, the same level, in GDP terms, as last year during the same period. Spending on compensation of employees, use of goods and services, and grants to other agencies for recurrent costs rose by 0.8 percent of GDP compared to last year. However, this was offset by smaller outlays on interest payments amounting to 0.3 percent of GDP due to lower interest rates (Figure 9), and a drop in outlays on subsidies and social benefits on the order of 0.4 percent of GDP compared to the same period last year.

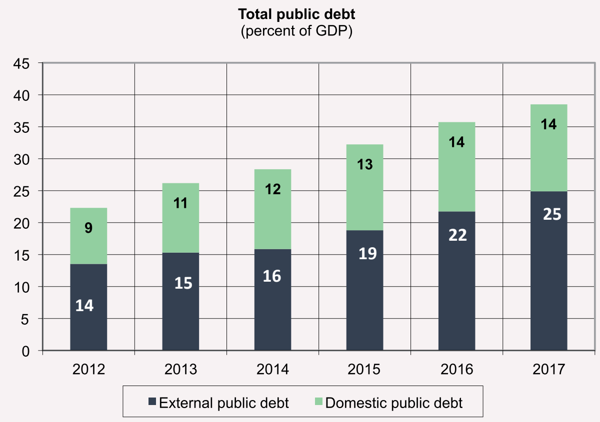
Over the last four years, the authorities have shifted the financing mix and relied more on foreign borrowing to meet the gross financing need (Figure 10). While in FY13/14 and FY14/15 the

Figure 11: Stock of verified arrears

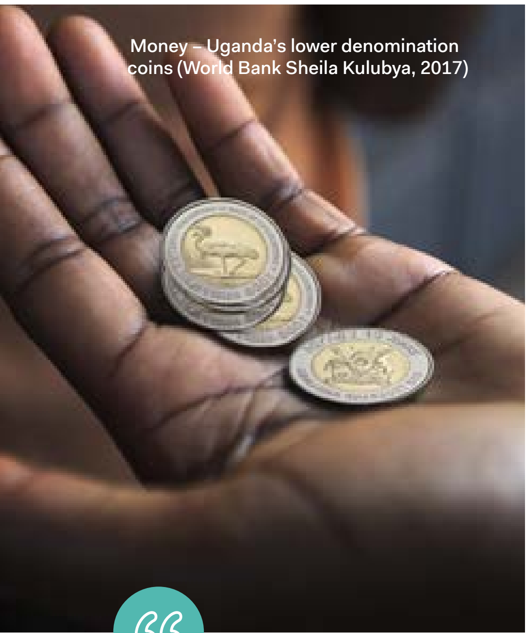


Source: MoFPED, Accountant General Office

Figure 12: Evolution of total public debt



Source: MoFPED and WB-IMF Debt Sustainability Analysis



Money – Uganda's lower denomination coins (World Bank Sheila Kulubya, 2017)

Government met between 60 and 70 percent of its gross financing need through domestic net issuances, this share fell in FY 2016/17 to below 20 percent. In the first half of FY 2017/18, net domestic financing from commercial banks and the non-bank sector stood at 0.4 percent of GDP, while Bank of Uganda net financed 0.2 percent of GDP. This implies net financing of 0.6 percent of GDP in the domestic debt market. In parallel, the stock of arrears to domestic suppliers verified by the Accountant General's Office grew by about 0.3 percentage points to 2.8 percent of GDP in December 2017 compared to a year ago (Figure 11).[10] Net external financing rose to 3.9 percent of GDP in the first half of FY 2017/18, which is 0.6 percent of GDP more than during the same period last year.

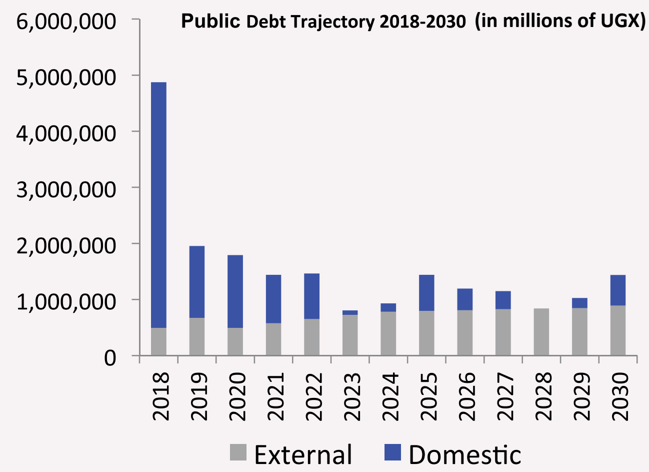
> The shift in the financing mix resulted in faster growth of external public debt, while domestic debt stabilized, in GDP term

External public debt stood at 40 percent of GDP at the end of 2017. The shift in the financing mix resulted in faster growth of external public debt, while domestic debt stabilized, in GDP terms (Figure 12). External public debt almost doubled since FY11/12, from 14 to 26 percent of GDP in FY 2016/17, while domestic debt stabilized at 14 percent of GDP. However, most of the loans in the Government portfolio are on concessional terms, with long grace periods and long maturities. Therefore, in present value terms, a measure that considers the favorable financing terms in the Government loan portfolio, external public debt amounts to 15 percent of GDP, as opposed to 26 percent of GDP in nominal terms. At the same time, the average term to maturity in Uganda, like in most Sub-Saharan countries, is rather short at 3.7 years, which results in elevated rollover risks, also called refinancing risks, and re-fixing risks as close to 40 percent of the domestic debt stock will come due in 2018 (Figure 13). In other words, if there is a negative shock, for example another episode of dry weather, and inflation accelerates to double digits, then government borrowing will suddenly become more expensive in the domestic market, and larger interest payments on domestic debt will reduce the fiscal space.

10 The stock of arrears is officially produced at the end of every fiscal year, while half year outcomes are intermediate estimates and should not necessarily be compared with end-FY figures. We use them here as rough indicators in which direction arrears are moving.

Government must have a fiscal rule in place to avoid overheating pressures and boom-and-busts cycles seen in other oil exporting countries in Sub-Saharan Africa

Figure 13: Principal repayment profile



Source: MoFPED

Money – Uganda's currency notes (Bank of Uganda, 2016)

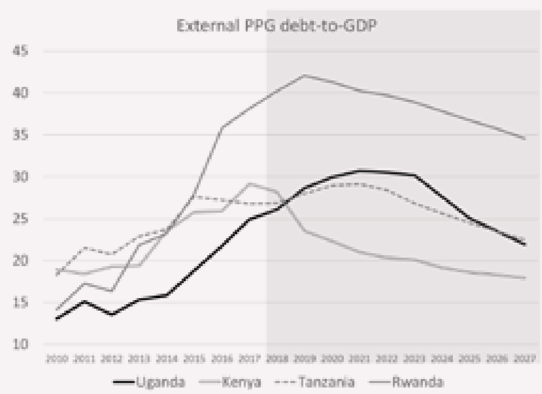
Despite sizable fiscal gross financing needs averaging 11.5 percent of GDP over the past five years, Uganda's external risk of debt distress remains low, based on the 2017 Debt Sustainability Analysis (DSA). The overall risk of debt distress rating continues to be low once domestic debt is added to the assessment. Since 2012, external public debt has risen around 12 percent of GDP driven by a scale-up in public investment, mainly in hydro-power. The latter is almost completed, but infrastructure investment such as, for example, energy/transmission projects, the planned refinery and pipeline to Tanzania, are expected to drive external public debt to roughly 31 percent of GDP over the medium term.

Uganda's external debt development appears sustainable, but should be closely monitored and fiscal rules put in place to ensure it remains sustainable. From 2012 to 2017, Uganda's debt-to-GDP trajectory lies below the trajectories of the other three peer countries such as Kenya, Tanzania, and Rwanda (Figures 14 and 15). Rwanda and Kenya have a larger external and overall public debt burden, compared to Uganda, whereas Tanzania exhibits a similar debt trajectory. In Uganda, the outstanding heavy investment agenda, once implemented, is expected to result in faster growth in debt than in real GDP. Infrastructure spending, in predominantly oil-related investments, is therefore likely to result in an upward debt trajectory until oil exports take off. From that point, it is expected that the debt-to-GDP will fall sharply, but for that to happen the Government must have a fiscal rule in place to avoid overheating pressures and boom-and-busts cycles seen in other oil exporting countries in Sub-Saharan Africa.

The overall risk of debt distress rating continues to be low once domestic debt is added to the assessment

The narrow export base in Uganda and export volatility are the most pronounced vulnerabilities to debt sustainability (Figure 16). Export volatility affects adversely the ability to generate foreign exchange needed to repay the increasing external debt service burden, that is interest and amortization payments in foreign currency. This volatility is caused by export revenues heavily influenced by movements in only a few commodity prices and/or circumstances that affect the production volumes. For instance, weather can have a significant impact on the exports because one-third of the export base represents agricultural products. With limited irrigation or water conservation infrastructure, export revenues and therefore foreign exchange inflows will in large part be a function of the volatility observed in weather patterns, and infestations. Hence, simulating a shock in the first two projection years that resembles a reduction in exports seen in the past results in a sharp increase in the debt-to-exports trajectory as the denominator (exports) falls and the Government borrows to import food (the numerator increases). However, with a take-off in oil exports around 2023, external public debt is expected to decline sharply thereafter.

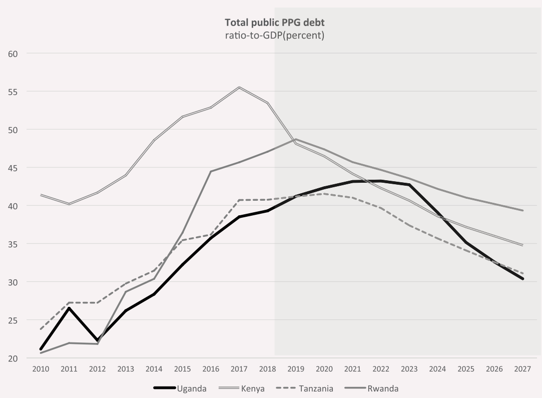
Figure 14: External public debt, nominal (in percent GDP)



Source: WB-MF Debt Sustainability Analyses

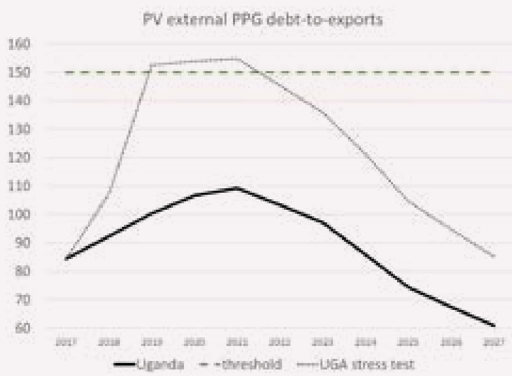
Uganda Stock Exchange in action, Kampala (Bank of Uganda, 2016)

Figure 15: Total public debt, nominal (in percent GDP)



Source: WB-MF Debt Sustainability Analyses

Figure 16: Vulnerabilities of debt sustainability



Source: WB-MF Debt Sustainability Analyses

02 ECONOMIC OUTLOOK AND RISKS

Women workers in a stone quarry in outskirts of Kampala (Artfield Graphics 2017)

2.1 Stronger real GDP growth expected from increased public investment and agriculture output

Real GDP is expected to grow close to 5.5 percent in FY2017/18, and could rise further to 6 percent in FY 2018/19, barring adverse weather conditions and continued inefficiencies in the execution of capital spending. This outlook is premised on improved food supply, which in turn assumes favorable weather conditions. It is also premised on foreign demand that would support further increase in exports. Imports are expected to continue rising driven by stronger economic growth and because of higher project-related government imports, should better execution of capital spending materialize. Better macroeconomic conditions should also be conducive to a rise in credit to the private sector, and result in higher growth in private consumption. The increase in private consumption and public investment would widen the current account deficit to around 5 percent of GDP in FY 2017/18, and close 6 percent in FY 2018/19, as the Government continues finalizing the construction of dams, and accelerates building the road network, including for oil-purposes in the western region. Investment in the refinery and pipeline to Tanzania is likely to be delayed.

After years of good progress, the tax-to-GDP ratio is unlikely to grow in FY 2017/18 compared to last year. Thus, the Government will not be able to meet the 0.5 percentage point increase in the tax-to-GDP ratio as mandated by the Charter of Fiscal Responsibility**.** The Government has recognized that it is unlikely to achieve this target, and has revised revising the nominal cash target for FY 2017/18 from Ush 16.7 to 15.9 trillion. At the same time, the execution of development expenditure continues to underperform, and is likely to be well below target. The delays in the execution of capital spending are likely to weaken the growth outlook. The overall fiscal deficit, including the repayment of arrears, could widen from last year's 3.9 percent of GDP (FY 2016/17) to around 4.5 percent in FY 2017/18. However, this is still below the deficit of 6.2 percent of GDP presented in the National Budget Framework Paper. In the context of current developments, the stock of verified arrears could exceed 3.5 percent of GDP by the end of FY 2017/18, compared to 3.2 percent recorded at the end of FY 2016/17. Underperforming tax collections and the overall low tax-to-GDP ratio highlights the urgency of implementing the next generation of tax reforms. Larger tax revenues would not only create fiscal space for social spending and safeguard debt sustainability, but would also unlock counter-party financing that often causes delays in capital expenditures. The special topic section describes the context of these reforms, and presents policy recommendations.

In the 2018/19 Budget Framework, the Government envisages a fiscal deficit of 5.4 percent. The Isimba dam could be completed by early 2019, while the Karuma dam may take a few more years before commencing operations. Whether the Government's envisaged deficit target will be achieved depends on the interaction between wage bill increases included in the FY 2018/19 budget and the execution of capital expenditures. spending that depends on the implementation of the oil-related road network in the western region, among others. Decisions related to pipeline modalities were planned to be announced by the end of June 2018, and those related to the refinery by end-June 2019. Delays are, however, likely, which would push these large capital investments to the outer years.

A farmer monitoring plant nurseries (Artfield Graphics 2017)

Weather-related shocks can derail real output growth as agriculture remains heavily dependent on rain and continues to exhibit low productivity

The Government recognizes the major challenges it faces, including the low revenue-to-GDP ratio and poor planning and budgeting. The buildup of arrears is the result of court awards and delayed payments to the private sector, which reflects weaknesses in public financial management. Finally, the Government sees low budget absorption for infrastructure projects as the consequence of the delayed acquisition of right of way for projects and lengthy procurement processes.

Barring severe unexpected shocks, the recovery in agricultural output will help the country return to a poverty reducing path again. However, such a path also requires modernizing agricultural production, and increasing the share of employment in and value added of non-agricultural activities (see Box 1). The focus should also be on addressing the vulnerability of households to weather and other unexpected shocks, reducing regional inequalities, ensuring universal access to all basic services, and reducing gender discrimination.

2.2 Risks remain tilted to the downside

In the short term, weather-related and pest shocks, as well as delays in executing public investments may constrain real GDP growth. Weather-related shocks can derail real output growth as agriculture remains heavily dependent on rain and continues to exhibit low productivity. Another weather shock would induce inflationary pressures due to a spike in food prices, and widen the fiscal and current account deficit. This could be further compounded by a disorderly rise in oil prices. Furthermore, if the execution of capital expenditure continues to be delayed, or if the large investment program fails to deliver a sizable growth dividend, then output growth could slow and place the public debt-to-GDP ratio on a steeper upward trajectory. This raises the urgency of containing leakages that undermine the collection of tax revenues and of maintaining tight control over tax expenditures.

Box 1. Structural policies required to raise productivity in agriculture

Uganda's agriculture potential is high, yet it remains unexploited. Uganda has diverse agro-ecological zones, comparably low temperature variability, and two rainy seasons in most parts of the country. However, this potential is not tapped for many reasons.

Ugandan agriculture exhibits low levels of technology and input adaptation. While agriculture commercialization has become the centerpiece of the sector priorities and interventions anchored in the Agriculture Sector Strategic Plan (2015/16 – 2019/2020), Uganda has one of the lowest adoption levels of improved seeds, inputs, mechanized traction, and productivity enhancing land management practices. Also, mechanization of agriculture is low in Uganda, and many small farmers cannot afford the necessary technologies and agricultural equipment. A leasing law is in preparation, which could promote leasing among stakeholders and facilitate private investment in the industry. Low quality seeds are prevalent, which significantly lowers returns, as only 13 percent of the crop area is planted with improved seeds. Other reasons for low technology adoption and commercialization levels are the weak regulatory measures and poor-quality control systems. Thus, delays in enacting changes to seed and fertilizer policy, as well as regulation capacity, dampen the productivity of the sector.

Uganda ranks amongst the lowest in the world in terms of fertilizer use. Only 2 percent of farmers use inorganic fertilizer, and its use remains concentrated on a few larger farms where cash crops are grown. No secondary regulations exist for detailing the four principal laws governing agricultural inputs (i.e. Seeds and Plant Act 2006, Agricultural Chemicals Act 2007, Plant Variety Protection Act 2014, Plant Protection and Health Act 2015).

Finally, it is estimated that over 30 percent of agricultural produce is lost due to the absence of storage facilities. Farmers often have no option than to sell their produce when prices are low. Efforts to develop a Warehouse Receipt System (and associated warehouse receipt policy) need to be pursued, along with interventions to facilitate low cost storage options at the individual farmer and farmer group levels. 2.3 Improving domestic tax revenues will create fiscal space for infrastructure investment and slow the build-up of public debt

Uganda's external debt development appears sustainable, but should be closely monitored and fiscal rules put in place to ensure it remains sustainable

Regional instability could undermine exports. South Sudan and the Democratic Republic of Congo (DRC) are Uganda's 2nd and 4th most significant export destinations. Intensified conflicts in these countries would have a negative impact on Uganda's exports, which in turn would also have negative implications for Uganda's current account and debt sustainability. The influx of refugees from South Sudan and DRC could place pressure on local service delivery systems and result in increased inter-communal tensions. However, it could also provide an economic stimulus, as refugee savings are spent and new businesses established.

2.3 Improving domestic revenues will create fiscal space for infrastructure investment and social safety spending, and safeguard debt sustainability

Lack of progress in tax collections demonstrate the fragility of improvement made over the past years. To raise the tax-to-GDP ratio, a fundamental shift in attitudes towards taxation is needed to improve the tax system's productivity. This would require a broadening of the tax base and reducing the revenue leakage from tax exemptions.

Economies with similar characteristics as Uganda indicate a potential to collect revenues of between 18 and 23 percent of GDP. This revenue potential stands in stark contrast to the current reality of tax collections on the order of 14 percent of GDP.

Uganda needs a revenue strategy to finance much-needed increases in expenditures that will help promote economic growth, safeguard fiscal sustainability, and enhance social spending. The development strategy is premised on a significant boost to capital expenditure, which should have the potential to support stronger macroeconomic growth over the medium term. At the same time, larger interest payments on public debt need to be accommodated within a relatively tight envelope for recurrent spending. This could crowd out spending in other areas, including health and education. Finally, a larger revenue envelop would help reduce the pace of borrowing and stabilize the debt-to-GDP trajectory.

The prospective oil revenues raise further the urgency of strengthening tax revenues. Over the next four to six years, Uganda is expected to start generating sizable oil revenues that could peak at 3 percent of GDP per annum in the longer term. Experience from other resource-rich countries suggests that the Government must establish a robust non-resource revenue base oil before revenues come on stream, given the negative relationship between resource revenues and domestic non-resource revenues, including from major taxes.

Considering the wide-ranging benefits of raising tax revenues, and the urgency of these reforms, the following special topic discusses tax policy and tax administration options, and recommends reforms that could put the tax-to-GDP ratio on an upward trajectory, so it can reach its potential.

“

Improving domestic revenues will create fiscal space for infrastructure investment and social safety spending, and safeguard debt sustainability.

PART 2

Uganda must raise more domestic revenues to meet development needs

A Mutuma Commercial Agencies factory worker packs goods for the market (World Bank / Morgan Mbabazi, 2013)

03 UGANDA'S DOMESTIC REVENUE EFFORT IS NOT MATCHING ITS GOOD ECONOMIC PERFORMANCE

Over the five-year period to FY 2016/17, revenue collection performance in Uganda improved and the ratio of revenue-to-GDP increased to nearly 14 percent of GDP. This performance is better than in earlier periods, where the ratio stagnated at around 12 percent of GDP. However, it was still below regional peers' and the Government of Uganda's own target of 16 percent of GDP. In the period from 1993 to 2013, the tax-to-GDP ratio grew by an average annual rate of 0.2 percentage points, with the ratio of collected taxes to GDP increasing from 7.6 percent to 11.6 percent (see Figure 16a). The value of non-tax revenues amounts to an additional 0.2 percentage points of GDP. In the five years to FY 2016/17, revenue collection performance improved as a result of new policy initiatives to expand the tax net; to collect non-tax revenues more effectively; and to achieve higher rates of compliance. With these measures, the ratio of domestic revenues to GDP increased to about 14.0 percent, with taxes alone constituting around 13.8 percent[11]. However, more recently, there have been significant shortfalls in revenue collections, largely due to a failure to sustain progress towards reducing tax expenditures[12]. In FY 2017/18, the total value of collected revenues is projected to reach 13.5 percent of GDP. In these terms, Uganda is lagging behind regional peers, with the tax-to-GDP ratio in Kenya standing at about 18 percent in 2016; in Rwanda at about 16 percent; and in Tanzania at about 14.5 percent. Overall, Uganda's ratio is lower than the average for the COMESA and the Sub-Saharan region more generally (see Figure 16).

11. Staff computations. Based on GDP data from UBOS and Revenue Data from Ministry of Finance, Planning & Economic Development.

12. Tax expenditures represent the cost to the economy resulting from exemptions, deviations or concessions from a regular tax (VAT, CIT or Excise) system, irrespective of the objective for the exception.

Figure 16: Uganda's tax revenues in comparison to potential and peers

Figure 16a. Uganda Tax Revenue, 1993-2015 (% of GDP)

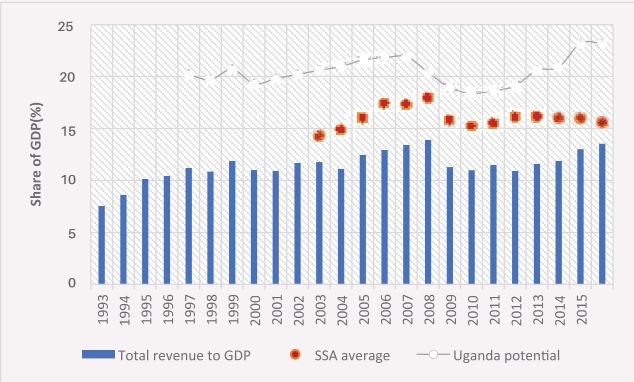
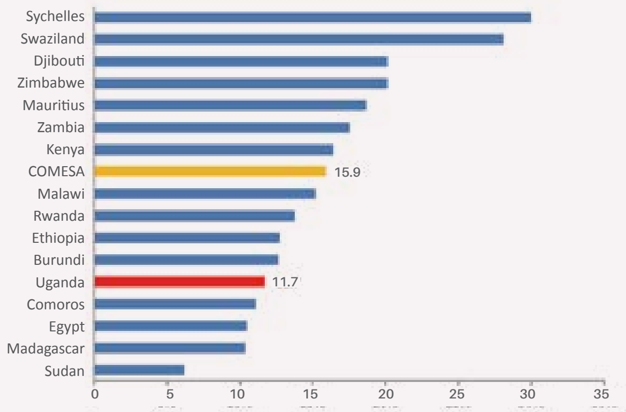


Figure 16b. Uganda trailing most COMESA countries' Tax Revenue (% of GDP), 2015



Sources: UBOS, URA and staff estimates for Figure 16a. ICTD database for Figure 16b)

Research has demonstrated that countries that achieve tax-to-GDP ratios in excess of 12.75 percent are significantly more likely to experience strong GDP growth due to the productivity gains associated with better public service delivery. With Uganda's tax-to-GDP ratio standing at 13.8 percent in FY2016/17, it could be in a position to reap these benefits.

Countries that fail to mobilize domestic revenues effectively are likely to face significant challenges in providing basic services; achieving sustainable fiscal balances; and keeping the public debt trajectory on a sustainable path. Thus, the Word Bank places great importance on the effectiveness of a country's mobilization of domestic revenues, setting a minimum threshold level for the ratio of domestic revenues to GDP of 15 percent for IDA countries, with an understanding that countries that fall below this threshold are likely to face challenges in financing basic state functions.[13] Other research has demonstrated that countries that achieve tax-to-GDP ratios in excess of 12.75 percent are significantly more likely to experience strong GDP growth due to the productivity gains associated with better public service delivery.[14] With Uganda's tax-to-GDP ratio standing at 13.8 percent in FY2016/17, it could be in a position to reap these benefits. However, with Uganda's rapidly increasing population and the challenges it faces in terms of delivering public services, such as education, health and infrastructure, of the appropriate quality and in sufficient quantity, it needs to intensify its revenue collection efforts.

While Uganda has implemented a wide range of reforms to its revenue policies and administration over the past 20 to 25 years, it must now intensify efforts to improve its performance still further. During the 1990s, the Government implemented a number of significant reforms, including the establishment of the URA in 1991; the introduction of VAT in 1996; and the reform of the income tax regime in 1997. These reforms contributed to an increase in the tax-to-GDP ratio from 6 percent in 1990

13. World Bank Group, IMF, OECD, UN (2016); Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries

14. Gaspar V., L. Jaramillo, & P. Wingender (2016); IMF Bulletin; Volume 17, Number 4; "Tax Capacity and Growth: Is There a Tipping Point?"


A busy section of Northern Bypass, Kampala (World Bank, Sarah Farhart, 2015)

Over the past few years, Uganda set the medium-term revenue-to-GDP target at

16%

with collected revenue to increase by an annual value equivalent to about

0.5% per year

to around 10.5 percent in 1999. In 2005, the Common External Tariff (CET) under the EAC Customs Union was adopted, and the URA was restructured along functional lines. By 2009, large and medium-sized taxpayer offices were established and the ASYCUDA World customs system was introduced. By 2012, the e-Tax system was introduced to systematize and standardize tax processes. Therefore, overall, Uganda's tax system is modern and its policy instrument design meets international legal standards, at least on paper. However, it is estimated that Uganda is still only partially fulfilling its potential in terms of collecting revenues. Uganda's potential[15] in this area was estimated to lie in the range of 18 to 23 percent of GDP in the period from 1997 to 2015.[16] This estimate indicates the boundaries within which technical and political discussions could take place with respect to how much revenue Government should aim to collect. Therefore, a renewed effort is required to close the gap between the country's tax effort and its potential over the medium to longer term, and to minimize the gap between tax revenues and increasing and sustained demands for service delivery and infrastructure.

With the Government formulating a new strategy to intensify its revenue collection efforts, this is an appropriate time to assess the successes and failures of the past to determine a path into the future. Over the past few years, Uganda set the medium-term revenue-to-GDP target at 16 percent, with collected revenue to increase by an annual value equivalent to about 0.5 percentage points.[17] Despite the targets, actual revenue collections have increased by an average annual rate of only 0.2 percentage points over the past two decades. A new medium-term revenue mobilization strategy (DRM-S) is currently under preparation and will play a critical role in addressing the gap. It provides an opportunity for Uganda to reboot its efforts to increase its revenues and to improve the manner in which these revenues are raised to ensure they are consistent with the achievement of the overall objectives of growth and equity. Efficient domestic revenue mobilization, combined with the efficient use of the resources is essential also for strengthening the social contract between the Ugandan government and her citizens.

15. Tax potential was estimated as the maximum level of tax revenues that Uganda could collect given a set of economic, social, demographic and institutional factors. The analysis based on a stochastic frontier modelling, used a panel data set for 175 countries over the period 1996-2015, for which the estimates for potential revenues were in the range of 18 to 23 percent of GDP.

16. Earlier estimates using a similar approach done by the IMF (Fenochietto and Pessino, 2010, 2013) but over the period 2000-2013 for 113 countries put Uganda's revenue potential at about 20 percent of GDP by 2013. However, Langford and Ohlenburg (2016), who employed the approach over a longer time frame between 1984 and 2010, suggested that Uganda's potential could rise to between 22 and 26 percent of its GDP.

17. See Government of Uganda's National Development Plan II from www://npa.go.ug.

In this context, the special topic in this Economic Update focusses on how Uganda can increase its revenues through reforms to tax policy and administration in the short to medium term. The subsequent sections analyze Uganda's achievements and the challenges it faces within the evolving economic structure; the distortions in the policy environment that reduce the effectiveness and productivity of the tax instruments; and the weaknesses in the revenue administration system, all of which need to be addressed for Uganda to collect increased tax revenues. More efficient taxation and the improved management and administration of the tax regimes are the means to improve revenue mobilization, as has been clearly demonstrated by the experience of many low- and middle-income countries.

04 POLICY DISCRETION AND INFORMALITY ARE CONSTRAINING EXPANSION OF THE REVENUE BASE

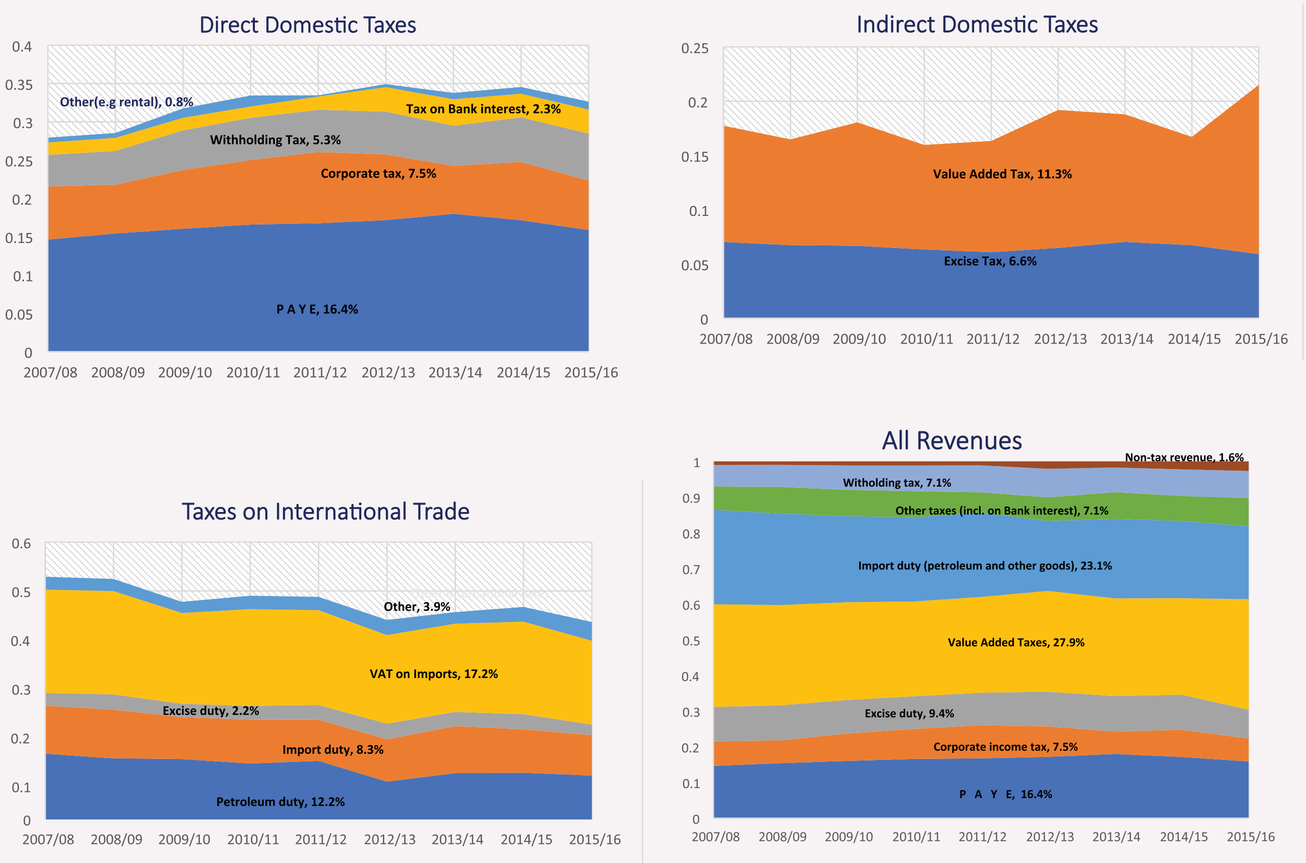
Kampala city (World Bank / Morgan Mbabazi, 2016)

VAT has accounted for a third of the total value of collected revenues, with the total value of collected VAT amounting to 4 percent of GDP in 2016

Tax revenues account for the largest proportion of Uganda's domestic revenues, with these revenues derived from a range of different types of taxes, of which VAT is the most important (see Figure 17). On average, VAT has accounted for around a third of the total value of collected revenues, with the total value of collected VAT amounting to 4 percent of GDP in 2016.

Of the total value of VAT, about 40 percent is collected from taxes on the domestic supply of goods and services, with the remaining 60 percent being derived from imports. The second most important source of domestic revenues is derived from duty on imports, which has accounted for an average of 23 percent of the total value of domestic revenues over the past decade. Up to 60 percent of revenues from this category is derived from duties imposed on petroleum products. Pay-As-You Earn (PAYE) on employment income is also an increasingly important source of revenue, contributing to an average of about 16.5 percent of the total, followed by excise duty (9.4 percent) and corporate income tax (7.5 percent). Overall, domestic taxes are making an increasingly significant contribution, with this contribution increasing from 47 to 56 percent of the total over the decade, driven by the increased contribution from VAT on domestic goods and decreasing contribution from trade taxes.

Figure 17: Contribution of Various Tax heads to Revenue Collection



Source: URA

Notes: (i) Graphs not drawn to the same scale (ii) Percentage numbers denote average share over the period 2007/08 to FY 2015/16.

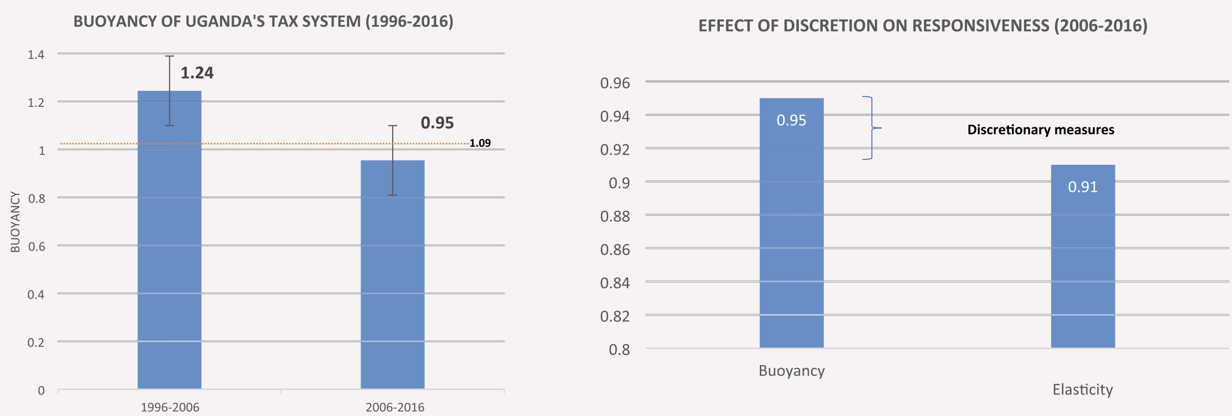
4.1. Changing economy yielded lower revenues

Uganda's tax revenue system has been negatively affected by the use of policy discretion, including tax exceptions. The impact of policy discretion can be demonstrated by estimating the difference between tax buoyancy (which measures the responsiveness of taxes collected to the changes in overall GDP) and tax elasticity (which is the same measure, but excluding the impact of policy changes on taxes collected). Estimates of this responsiveness for Uganda[18] show that buoyancy has declined from an estimated 1.24 percent in the period from 1996 to 2006 to 0.95 percent during the period from 2006 to 2016 (see Figure 18, LHS). Furthermore, for the period from 2006 to 2016, the tax buoyancy rate of 0.95 was slightly higher than the estimated tax elasticity rate of 0.91 percent (see Figure 18, RHS). This gap reflects the impact of discretionary measures (a detailed discussion of these discretionary measures is presented in Section 3). In addition, the estimated figure for the past 10 years is lower than the long-term tax elasticity measure of around 1,[19] suggesting that Uganda has not been operating at the long-term stable level.

18. These estimates of 'buoyancy' and 'elasticity' are derived through regression analysis of revenue and GDP time series data for the period 1996 to 2016, provided by URA and UBOS, respectively.

19. Recent estimates in the Dudine and Tovar (2017), which uses cross country panel data, indicate Uganda's long-run tax elasticity stands at 1.18, with this not significantly different from 1.

Figure 18: Responsiveness of taxes to GDP with and without discretionary measures (1996-2016)



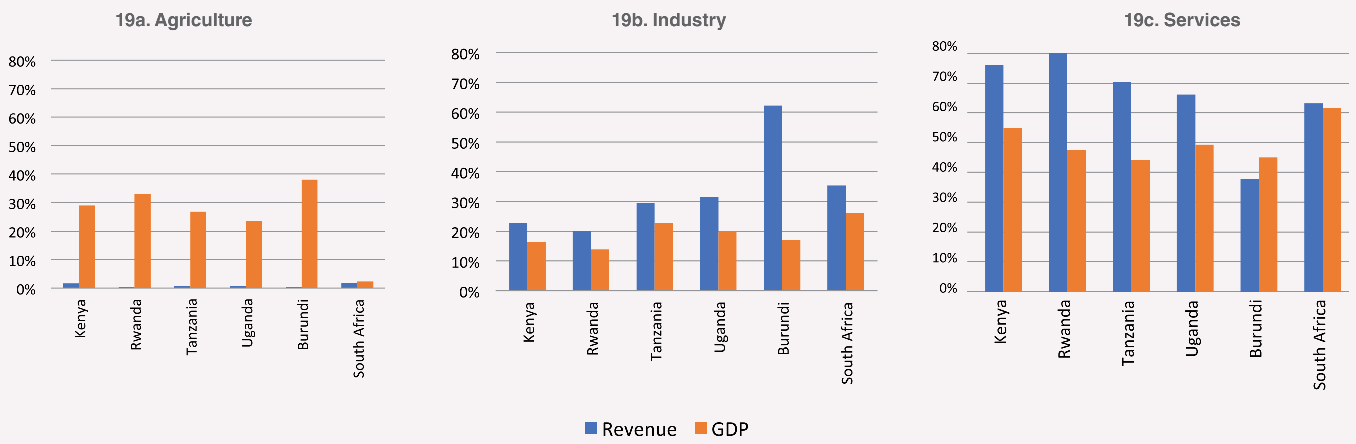
Source: Staff estimates based on data from UBOS and URA

On average, VAT has accounted for around a third of the total value of collected revenues, with the total value of collected VAT amounting to 4 percent of GDP in 2016. Of the total value of VAT, about 40 percent is collected from taxes on the domestic supply of goods and services, with the remaining 60 percent being derived from imports.

While the significant changes to Uganda's economic structure over the past two decades should have had a positive impact on tax collection, this has not been the case. In the period from 1990 to 2016, the contribution of the agricultural sector to GDP declined from around 55 percent to around 23 percent, while the contribution of services increased from 31 percent to 47 percent (see Figure 19a) and the contribution of industry from 14 percent to 31 percent (see Figure 19b). In almost all peer countries, the level of revenues collected from the imposition of taxes on agriculture is relatively very insignificant. This also holds true for Uganda. In Uganda, 66 percent of total taxation revenues are derived from the services sector, and 31 percent from industry. While Uganda has tapped some of the potential created by the expansion of its services sector, its revenue collection efforts still lag peer countries.

As is the case with its regional peers, Uganda's services sector is the most significant contributor to revenues, although the contribution of this sector in Uganda is relatively small compared to the case in Kenya and Rwanda (see Figure 19c). This difference could be because other sectors are not contributing sufficiently to the revenue base in the other countries. However, it does not change the fact that services have a large component of high-value, well-documented activities that should contribute to the revenue base. In Kenya, the services sector contributes up to around 76 percent of the total value of revenues, with this sector contributing to around 55 percent of GDP. In Rwanda, the services sector contributes to around 80 percent of the total value of revenues, despite contributing to a relatively smaller proportion of GDP compared to Uganda. In Uganda, the majority of tax revenues is derived from formalized activities, particularly those in the financial sector. Other subsectors, including the trade, communication, transport, storage, accommodation and food services subsectors, contribute to a relatively small proportion of revenues. In particular, the buoyancy rates for accommodation and food services are very low, at around 0.2 percent.

Figure 19: Evolution in GDP and revenue by Economic Activity



Source: URA: Figures compiled from data from Revenue Authorities for respective countries and Statistics Offices

Tea harvest in Mubende (World Bank / Morgan Mbabazi, 2016)

The vibrant information and communications sector is also characterized by a remarkably low buoyancy rate, suggesting that a significant proportion of activities within this sector are not taxed effectively. There are three possible explanations for this. First, it could be related to the nature of ICT company value chains, which are characterized by the outsourcing of services (labor, towers, etc.) and the use of a wide range of distribution networks. Second, it could be related to changing consumption patterns for telecom services from voice to data and Over the Top (OTT) services, which may not be captured adequately in the tax base.[20] OTT service providers[21] are not regulated by the Uganda Communications Commission (UCC), with this lack of regulation enabling them to provide messaging and voice services at low fees or without charge to clients. Consumers purchase goods and services from global OTT operators, not local operators, who would be obliged to pay taxes in the countries in which they are domiciled.[22] Third, systems for the effective taxation of the telecommunications sector are difficult to design and implement, especially considering the rapidly evolving tax base. In sum, the evolution of electronic media has been characterized by the use of

20. The existing excise duty base for voice communication is on airtime on mobile telephony and landlines (internet is not subject to excise duty). When callers switch from using normal mobile telephone or landline calls or messaging services to using VoIP technologies including messaging and voice calls on WhatsApp or similar apps, the excise base is eroded to the extent that the use of OTT to make voice calls or send messages is not subject to excise duty.

21. Facebook, WhatsApp, Viber, Skype etc.

22. Countries like Pakistan and India are reviewing licensing frameworks and consider issuing licenses to OTT players before they can operate in their jurisdictions.

technological innovations, outsourcing, multilayer value chains, and electronic commerce, all of which make it difficult to effectively tax the sector, as does the dynamic behavior of communication services users. Furthermore, most firms operating in this sector are multi-national companies that can avoid taxes using transfer pricing mechanisms, which makes the effective taxation of the sector even more challenging. Given these challenges, Uganda may need time to develop and adapt a tax framework that is most suited to the unique features of this sector. Until such a time Uganda develops the ability to regulate and license OTT service providers, the tax base from this stream is likely to continue to decline.

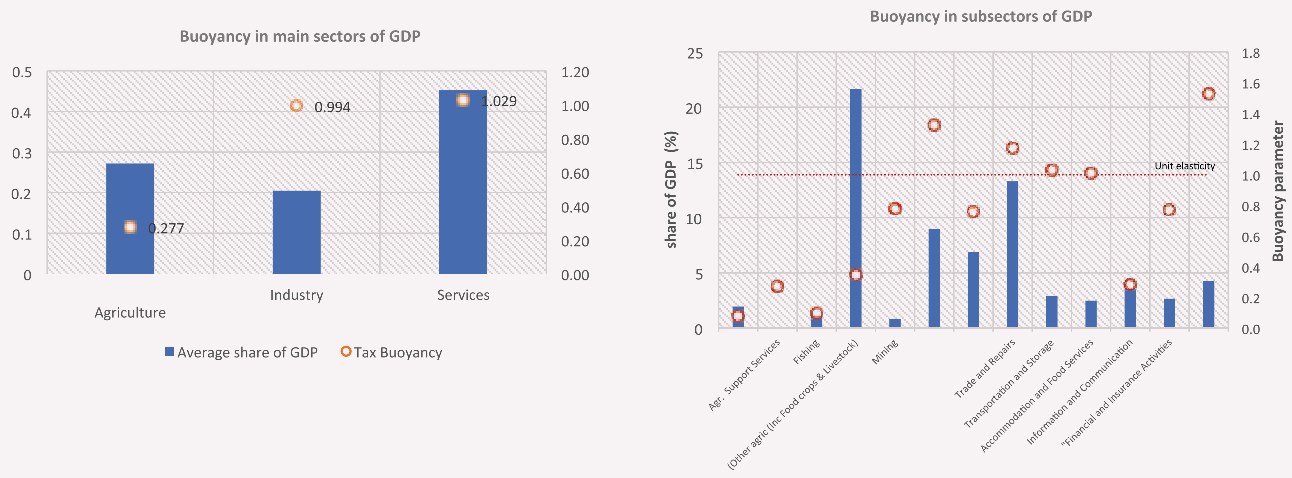
> Uganda's economic transformation has been characterized by the proliferation of micro, small and medium enterprises (MSMEs), which exhibit low levels of productivity and high levels of informality.

In Uganda, while the industrial sector contributes to a relatively high proportion of total revenues relative to regional peers, within this sector, the construction and mining sub-sectors do not contribute their expected share. The most significant proportion of taxes from Uganda's industrial sector come from manufacturing (see Figure 20). By contrast, the buoyancy rate for the mining and construction subsectors is just as low as that of ICT. This is mainly because these subsectors are characterized by high levels of informality, with a lack of appropriate regulation and monitoring to integrate them into the tax base.

As is the case with regional peers, Uganda's agricultural sector makes the least significant contribution to collected tax. This sector contributes to 23 percent of GDP, but to less than 1 percent of total revenues. This share is relatively low compared to the figure recorded in Kenya, which stands at 1.6 percent, with the contribution of Kenya's agricultural sector to GDP also slightly higher, at 29 percent. Interestingly, the buoyancy rates for fishing and cash crops are relatively the lowest, with these figures indicating that growth in nominal GDP of 1 percent results in growth of tax revenues from this activity of below 0.2 percent.

23. The Income Tax Act exempts Micro taxpayers with turnovers below UGX 10 million. Flat presumptive taxes (varied depending on business trade and location) are charged on business with turnover ranges between UGX 10 million- 50 million. MSMEs with turnovers exceeding UGX 50 million, but less than UGX 150 million pay presumptive tax of 1.5 percent on gross turnover. The VAT threshold beyond which taxpayers are required to be on the VAT register is UGX 150 million.

Figure 20: Buoyancy of taxes to GDP growth for main sectors and sub-sectors of GDP (1999-2016)



Source: UBOS and URA data

Green coffee beans (World Bank / Morgan Mbabazi, 2016)

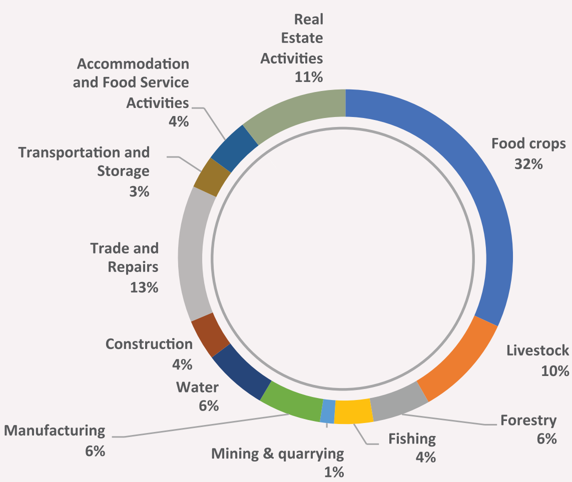
> Uganda's agricultural sector contributes to **23%** of GDP

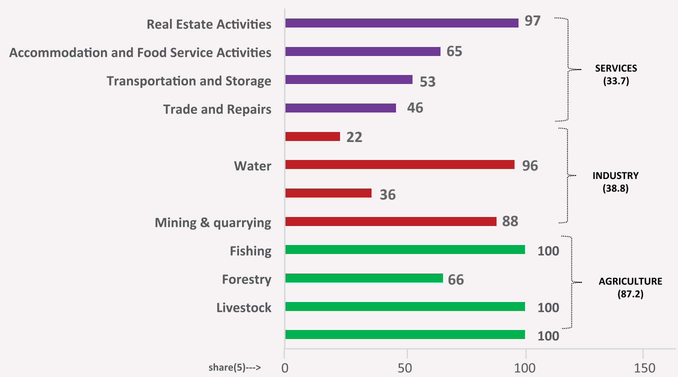
Across sectors, the high level of informality in Uganda has contributed significantly to the limited responsiveness of taxes to economic activity. According to UBOS, the informal sector contributes to about 45 percent of economic activity. Uganda's economic transformation has been characterized by the proliferation of micro, small and medium enterprises (MSMEs), which exhibit low levels of productivity and high levels of informality. By 2010, Uganda's MSMEs accounted for more than 85 percent of all non-agricultural enterprises, contributing to more than 75 percent of total value added in GDP and employment. Notwithstanding the MSME Tax regime,[23] many of these firms are still hard to reach, as many conduct financial transactions in cash, making it easy for them to hide their economic activities from tax authorities. In addition, businesses are highly mobile, with services often delivered from no permanent address. Others operate without regulation and/or do not register with the appropriate authorities. Under these circumstances, a significant proportion of the formal sector's transactions may involve transactions with informal firms, which leave no audit trails and hence most likely reduce the payment of taxes from firms in the formal sector. Within the services and industrial sectors, for example, such transactions may relate to real estate activities, accommodation and food services, transport, construction, water, and mining, a large proportion of which remain informal (see Figure 21).

4.2 Strategies to include informal firms and transactions in the revenue base

Measures to streamline tax policies and the regulatory environment are just as important as improving administration. As an example, the MSME tax regime aims to reduce the tax burden on micro firms, and by doing so, to minimize both compliance and administration costs. URA has also made efforts to address informality by creating withholding tax regimes

Figure 21: Informality in Uganda's Economy (2013-2017)





Source: Uganda Bureau of Statistics

> A number of changes to the economic environment could have significant implications on the abilities of the Government to collect taxes. Efforts to increase formalization would facilitate the increased collection of taxes from businesses and individual income earners

and collaborations with Kampala City Council Authority (KCCA), and the Uganda Registration Services Bureau (URSB) to identify tax payers. These efforts could be complemented with additional reforms in the following areas:

a. **Tax the agriculture sector and rely on appropriate VAT and income thresholds to protect the poor, rather than through exemptions on the consumption side:** Currently, the income tax law exempts income derived from agro-processing, and the VAT law exempts unprocessed foodstuffs, agricultural products and livestock. Exempting agriculture from taxation is justified in terms of equity concerns, with the stated goal being to provide support to small farmers. However, these exemptions also exclude large farmers and cattle breeders from the tax base, with the result being that in terms of absolute value, the level of support provided to large farmers significantly exceeds that provided to small farmers. This makes the stated justification for these exemptions unconvincing. As a possibly more equitable alternative, it might be appropriate to establish VAT and income thresholds in the agriculture sector to exempt small farmers from certain taxation requirements, while ensuring large farmers that produce significant values of cash crops or cattle are included in the tax base. Once big farmers are compliant with VAT requirements, those producing significant profits should also be subjected to corporate income tax. Thus, for the introduction of VAT in agriculture, a VAT threshold of UGX 150 million might be optimal, as this would ensure the inclusion of large farmers in the VAT base.

b. **Strengthen the relationship between local governments and the URA to facilitate the collection of taxes.** The participation of local governments in the identification of informal businesses and the assessment of their tax liability often leads to better results than if these processes are fully implemented by central authorities. For instance, the Single Business Permit (SBP) required by all businesses helps to improve the level of revenue collected from payments for public services and promotes political responsibility and improved accountability. The partnership between KCCA, URA, and the URSB code, known as the Tax Payer Register Expansion Project (TREP), is a great example of how partnerships between central government and local government entities can result in improved registration compliance by operators within informal sectors, facilitating an expansion of the tax register. However, beyond registration, initiatives to ensure declaration and payment compliance need to be in place to genuinely tap into the informal sector. Once the implementation challenges such as inadequate declaration and payments, non-compliance, have been overcome, these initiatives should be encouraged, strengthened, and rolled out countrywide using existing local government structures.

c. **Create non-tax based incentives for compliance with tax requirements.** The Government could establish systems to provide incentives for compliance. One example would involve encouraging small, informal actors to create synergies by working together through participation in cooperatives and savings and credit unions, which are primarily intended to facilitate members' production and marketing activities and access to credit, but which could also be used to enhance contributions to the tax system. Other measures that may be effective could involve measures to reduce the propensity to conduct transactions in cash, which is indicative of the size of the shadow economy. While these measures may be considered as financial reforms whose primary purpose is to deepen the financial sector, tax administrations in many countries (e.g. South Korea and Mexico) have worked with banks to issue points of sale through a combination of incentives (e.g. value-added tax cut) and legal obligations (e.g., requiring card acceptance by merchants of a certain size). In Uganda, use of telephone mobile money services, which facilitates financial inclusion, has created alternatives to cash transactions,[24] and a possible trail for linking money flows to economic activity. This form of financial inclusion needs to be strengthened to reduce the use of cash in the economy.

> In Uganda, use of telephone mobile money services, which facilitates financial inclusion, has created alternatives to cash transactions, and a possible trail for linking money flows to economic activity. This form of financial inclusion needs to be strengthened to reduce the use of cash in the economy.

d. **Strengthen the relationship between local governments and the URA to facilitate the collection of taxes.** The participation of local governments in the identification of informal businesses and the assessment of their tax liability often leads to better results than if these processes are fully implemented by central authorities. For instance, the Single Business Permit (SBP) required by all businesses helps to improve the level of revenue collected from payments for public services and promotes political responsibility and improved accountability. The partnership between KCCA, URA, and the URSB code, known as the Tax Payer Register Expansion Project (TREP), is a great example of how partnerships between central government and local government entities can result in improved registration compliance by operators within informal sectors, facilitating an expansion of the tax register. However, beyond registration, initiatives to ensure declaration and payment compliance need to be in place to genuinely tap into the informal sector. Once the implementation challenges have been overcome, such initiatives should be encouraged, strengthened, and rolled out countrywide using existing local government structures.

e. **Explore other economic reforms that could support revenue mobilization.** A number of changes to the economic environment could have significant implications on the abilities of the Government to collect taxes. In India, for example, when the government carried out a currency reform, it had the impact of attracting holders of cash into the banking system. While the main aim of this reform was to restore the value of the currency, it also indirectly supported revenue mobilization efforts, as it was also combined with a requirement to declare tax by filing returns.

These efforts to increase formalization would facilitate the increased collection of taxes from businesses and individual income earners by establishing a culture of compliance, promoting fairness and upholding the social contract.

24. According to BOU, by 2017, mobile money transactions had reached a value worth UGX 55 trillion, which is over 60 percent of GDP.

05 ADDRESSING POLICY DISTORTIONS CAN RAISE THE PRODUCTIVITY OF TAX INSTRUMENTS

Production processes at Roofings (U) Ltd (World Bank / Morgan Mbabazi, 2016)

In Uganda, the practice of zero-rating non-export items has created challenges for revenue administration and collection, with some taxpayers miss classifying standard-rated items to evade taxation obligations

If Uganda had minimized the rate at which it provides tax reliefs, it could have achieved a tax-to-GDP ratio of between 16 to 20 percent. In FY 2016/17 alone, the value of revenues forgone due to exemptions across all tax types was estimated to stand at around 4.0-5.0 percent of GDP.[25] This amount included forgone revenues from domestic VAT amounting to 2.5 percent of GDP; from the CIT system to 1.0-2.0 percent of GDP; from excise duty to 0.43 percent of GDP; and from the proportion of non EAC duty exempt imports to 0.9 percent of GDP.

The tax exemptions under PIT are also significant, but have not yet been calculated in detail. In addition, tax compliance issues exacerbate the weak tax collection performance, with significant potential for fraudulent offset claims to VAT[26] (2.7 percent of GDP).[27] With the current tax-to-GDP ratio standing at around 13-14 percent, tax reforms designed to reduce tax reliefs; to close other tax policy gaps; and to strengthen tax administration, are all vitally necessary measures. This section highlights a range of issues signifying these policy distortions and the corresponding reform options.

5.1 Value Added Tax (VAT): Blocking Leakages arising from tax exemptions can improve VAT productivity

Accounted for on a cash basis, the value of collected VAT is estimated at 4 percent of GDP, a figure that still lags behind several key regional peers. Uganda's VAT collection performance is still weaker than that of Kenya and Rwanda, where the value of collected VAT amounted to around 4.5 percent of GDP in both cases, at least until 2013, the last year for which data are available. At an average rate of about 20 percent over the past decade, Uganda's VAT productivity[28] is amongst the lowest in the East African Community (EAC), with Kenya recording a rate of 36 percent; Tanzania of 29 percent; and Rwanda of 23 percent.[29]

25. An assessment of the tax expenditures, to determine the revenues forgone, was undertaken in the report– "Assessing potential revenue gaps in raising domestic revenues in Uganda, 2017", jointly prepared by the GOU and World Bank in 2017. The tax expenditures were computed using the "revenue foregone method", following the ICAS guidelines. The estimate captures both discretionary incentives given by government and those automatically claimed by tax payers in their tax declarations, for the four main taxes (i.e. VAT, CIT, excise duty and Customs). The value of tax expenditures published by government on the Ministry of Finance, Planning and Economic Development website, estimated at about 3 percent of GDP), covers discretionary tax expenditures only. The benchmark against which tax expenditures are measured varies across countries, and for that reason, interpretation of estimations of level and composition of revenue forgone should be undertaken with caution. For that reason, the estimate in this report provides the range of 4-5% of revenue forgone.

Uganda is running a negative cumulative VAT Account amounting to about

2.7% of GDP

At an average rate of about 20 percent over the past decade, Uganda's VAT productivity is amongst the lowest in the East African Community

Uganda's low and declining VAT productivity rate indicates that the VAT taxation system is not operating efficiently and is suffering from an eroded base. The main factors causing this situation include the following:

(i) **The practice of allowing taxpayers to claim excess VAT paid on purchases, which in some instances is higher than the VAT a taxpayer collected from buyers of his products, is appropriate to ensure that firms do not suffer cashflow challenges and only pay the appropriate amount in taxes.** However, the manner in which it is implemented in Uganda creates the potential for abuse. At present, if all offset claims indicated in taxpayers' tax returns were to be refunded, the Government would refund all cash VAT collected and obtain a negative position estimated at about 1 percent of GDP. This means that even though VAT paid to Government in cash and accounted for amounts to about 4 percent of GDP, Uganda's total declared output VAT on goods/services sold is less than the total declared VAT paid by traders on their purchases. Technically it implies that Uganda is running a negative cumulative VAT Account. In 2016, this position was mainly explained by offsets carried forward, with the value of these offsets amounting to about 2.7 percent of GDP (i.e. UGX 2.4 trillion). Individually, the 32 top VAT claimants submitted claims to a value in excess of UGX 5 billion in each case. Taken together, the value of these 32 claims amounted to a figure in excess of UGX 223 billion (equivalent to 0.25 percent of GDP). In addition, offsets are entered manually in the monthly VAT returns/forms, which has the potential to create errors in the claim process.

(ii) **VAT revenue foregone due to deviations from the standard or regular VAT system amount to an estimated 2.5 percent of**

26. Section 42 (2) a of the VAT Act, Cap 349 allows taxpayers with VAT refunds which are less than 5 million or taxpayers who mainly deal in zero rated supplies to carry forward VAT claims and offset them against future tax liability. Accordingly, offsets arise when a taxpayer, who would have been qualified for a refund chooses not to lodge a refund claim, but rather defer such receivable to the future with the hope that he can claim it against future positive VAT liability.
27. Taxpayers who are keen on avoiding audits triggered by a refund claim, may choose to lodge an offset claim which currently receives no major compliance based audit focus.
28. VAT productivity is defined as actual VAT revenue as a percentage of GDP divided by the standard VAT rate
29. Data source: US Agency for International Development: collecting taxes series 2007-08 to 2012-13.

GDP.[30] This value is normally referred to as the tax expenditure.[31] Given the current level of VAT collection (4 percent of GDP), the tax expenditure on VAT constitutes a significant loss of revenue, with this value estimated to reach 62.5 percent of the value of actual collections. Despite the high level of loss, this has not been closely monitored.

(iii) **The revenue foregone due to the application of VAT zero-rates amounts to about 1.5 percent of GDP.** Uganda applies zero-rates to exported goods and to the international transportation of goods or passengers, which is good practice. However, the list of goods eligible for zero-rating expands beyond this good practice.[32] Uganda could significantly increase its revenues by reducing the list of zero rated items. In this regard, it could learn from the experience of its neighbors. Among EAC countries, Kenya applies zero-rates to only two items apart from exported goods, these being natural water and the transfer of business (as going concern). Rwanda is even more restrictive, applying zero rates only to exports and to donor funded projects. In Uganda, the practice of zero-rating non-export items has created challenges for revenue administration and collection, with some taxpayers miss classifying standard-rated items to evade taxation obligations.

> VAT exemption is good practice for merit goods or services, and for goods and services that are hard to tax, such as educational and financial services

(iv) **VAT exemptions on domestic sales result in forgone revenues amounting to a value of about 0.84 percent of GDP.** VAT exemption is good practice for merit[33] goods or services and goods and services that are hard to tax, such as educational and financial services. However, exempting goods and services which are neither hard-to-tax nor meritorious results in the unnecessary loss of revenue. In addition to foregone revenue, extensive VAT exemptions create two major problems. Firstly, exemptions break the VAT chain and cause inefficiencies due to cascading, which leaves a tax content on end products. This distorts the choice of consumer goods and inputs by producers, and renders exports less competitive, even if those are zero-rated. Second, the extensive

30. To compute cost of VAT exemptions, VAT returns were used to determine zero rated supplies (excluding exports) and exempt domestic sales. VAT domestic sales were adjusted for items exempt under VAT normative regimes, and a proportion that may have reflected intermediate sales. The customs database was used to identify import on which VAT was not paid. Goods that are traditionally exempted such as petroleum products (these attract excise duty), goods related to education, health, veterinary sectors or armed sectors were excluded for purposes of computing revenue foregone. The resulting revenue was discounted by 18.7% (value of imports in the final value added) to remove value of imports that would have been claimed back if the importers are registered for domestic revenue purposes.

31. According to Bank of Uganda statistics, by 2017, mobile money transaction had reached a value worth UGX 55 trillion, which is over 65 percent of GDP.

32. Uganda's list of non-export zero-rated items include: (a) Drugs and medicines; (b) Educational materials used in schools, colleges, universities and institutions engaged in adult education, vocational or technical education or training for handicapped persons; (c) Seeds, fertilizers, pesticides and hoes; (d) Cereals where these are gown, milled or produced in Uganda; (e) Sanitary towels and tampons and inputs for their manufacture; (f) Supply of leased aircraft, parts and maintenance equipment; and (g) Handling services with respect of medical supplies funded by donors

exemptions increase both the administrative burden and the cost of compliance for taxpayers.

(v) **While some VAT exemptions may have been previously justifiable, they may now have become obsolete.** The list of VAT exemptions mandated by the Fifth Schedule of the East Africa Community Customs Management Act, 2004, contains items for which exemptions may no longer be justified. Using this schedule, exemptions have been granted on some imported goods, while locally manufactured goods are not exempt. This results in variations in the application of VAT on local and imported items. Furthermore, in the case of some imports, exemptions for which there is no solid legal basis may have been be granted. For example, imported exercise books are exempt from VAT. There is no solid legal basis for this exemption, with the law stating that only books intended for inclusion in libraries qualify for exemption.

(vi) **While there is a solid legal basis for both the VAT Refund System and for VAT offset processes, the manner in which associated processes are implemented may result in leakages.** In the period from 2013 to 2015, the average total value of claimed refunds amounted to UGX 400 billion (i.e. about US$ 120 million, or about 0.5 percent of GDP), with an average of about 4,000 refund claims.[34] In practice, only about 50 percent of claims are paid promptly. The balance remains unprocessed for long periods of time. This creates a general impression that the refund system is unfair and arbitrary, while also creating potential opportunities for fraud.

(vii) **Some innovations to address economic management problems elsewhere have adversely affected the implementation of the VAT system. This is the case for the practice of deeming VAT,[35] with the original objective being to overcome cashflow problems in donor funded projects and oil related activities, but which may now be eroding the revenue base and negatively impacting compliance.** Provisions for deemed VAT are primarily intended for donor funded projects and for petroleum operations that have not yet begun exporting. However, the manner in which the system for calculating deemed VAT is implemented in Uganda has eroded the revenue base and negatively impacted the compliance culture, with large numbers of taxpayers other than the intended groups demanding to benefit from the practice. Elsewhere in the region, some countries have specific procedures for aid funded projects that do not involve deemed VAT (i.e. zero rate or exempt supplies for

Uganda's currency notes and coins
(World Bank / Morgan Mbabazi, 2016)

The revenue foregone due to the application of VAT zero-rates on non-exports amounts to

1.5%

33. These goods and services are defined as considered so meritorious that their satisfaction is provided for through the public budget, over and above what is provided for through the market and paid for by private buyers.

34. Analysis based on data from Uganda Revenue Authority for the years 2013, 2014 and 2015.

35. Deemed VAT refers to the practice of assuming that VAT has been paid whereas not. It is therefore VAT charged by a supplier on a VAT invoice, the supplier does not receive VAT value in cash from the buyer and consequently will not remit to the tax authorities. On the other hand, the taxpayers are allowed to claim full credit for VAT paid on inputs. Deemed VAT is available to multiple levels in the VAT chain for aid funded projects and petroleum operations contractors.

direct or exclusive use in aid funded projects).[36] By contrast, Ugandan law deems VAT to be paid on aid funded projects at multiple levels of the VAT value chain.[37] This creates opportunities for abuse and difficulties for tax administration. Since the inception of Uganda's deemed VAT system in July 2015, no data has been gathered to calculate the value of cash revenue foregone as a result of VAT being deemed to have been paid. However, for the period from July 2016 to December 2016 alone, revenue to a value of about 0.008 percent of GDP (i.e. UGX 6.9 billion) was not remitted to the URA as a result of this practice. The sectors which benefit to the greatest extent from this practice are the administrative and support service subsectors, with these subsectors accounting for 29.2 percent of the total value of deemed VAT; wholesale and retail trade (13.6 percent); repair of motor vehicles and motorcycles (12.5 percent); professional, scientific and technical activities (12.5 percent); manufacturing (12 percent); and mining and quarrying (7.9 percent).

Overall, VAT exemptions lead to significant foregone revenues. Notwithstanding the numerous leakages from the system, there is no rules-based governance framework that adequately captures, monitors and analyses the extent of these exemptions.

> Since the inception of Uganda's deemed VAT system, no data has been gathered to calculate the value of cash revenue foregone as a result of VAT being deemed to have been paid

Reform Options

With the political will, most of the reforms required to improve the VAT administration and collection system could be effectively implemented in the short term. These reforms include the following:

a) Reforms to the VAT offset regime: The VAT offset regime should be reviewed by enforcing the value of how much VAT offset[38] can be carried forward or setting a statutory time limit. After this time limit, offsets should be stopped or refund claims lodged which can be audited by URA for settlement. Second, the URA should eliminate the option to enter offsets manually in the e-Tax monthly returns. Third, URA should intensify audit compliance action on offsets

b) **Establish a Tax Expenditure Governance Framework to assess tax exemptions**: The authorities should establish a Tax Expenditure Governance Framework to assess the efficiency, impact and equity of tax

36. A comparative analysis of VAT treatment of government procurement in the region, indicates that Kenya and Tanzania exempt supplies made for aid funded projects. Rwanda zero rates supplies made for aid funded projects, while South Africa deems them exported (hence zero rate) to the international organization or aid agency. The EU, New Zealand subject all government consumption to VAT.

37. For example, if supplies by a Contractor X to an MDA (Level 1) are deemed VAT paid, then supplies to this Contractor X (Level 2) are also deemed VAT paid.

38. The current limit of UGX 5 million was set in 1996 and could benefit from indexation to reflect inflation and current realities.

exemptions, with this framework being used as a basis to reduce or minimize exemptions. The framework[39] should: (i) include a clause that refrains any authority from granting discretionary exemptions in whatever form; (ii) subject each new exemption or VAT zero rating to an extensive cost/benefit analysis; (iii) evaluate existing VAT exemptions to determine whether they remain relevant, with the public disclosure of the associated analysis to ensure greater transparency; and (iv) establish a ceiling on VAT exemptions, with the publication of reports on the degree to which compliance with this ceiling is achieved. The establishment of this framework and the promulgation of the associated fiscal rules could reduce the number of exemptions and thus increase the total value of collected VAT.

c) **Review the domestic zero VAT rating system:** A review of the exempt schedule should be conducted to rationalize to bring it closer to standard good VAT practice (i.e. only exports should be zero rated. As an example, specific consideration should be given to abolishing the zero rating for cereals, with the imposition of a threshold to protect small farmers, producers and millers, as discussed previously.

> The authorities should establish a system to evaluate exemptions to eliminate inefficiencies and anomalies and to rationalize the VAT base. It is necessary to balance the value of social externalities against the cost of exemptions.

d) **Eliminate inefficient exemptions and anomalies:** The authorities should establish a system to evaluate exemptions to eliminate inefficiencies and anomalies and to rationalize the VAT base. Again, it is necessary to balance the value of social externalities against the cost of exemptions. For example, while there is clearly a high social cost to ensuring that all members of society have affordable access to materials to support primary and secondary education, consideration should be given to placing supplies needed by commercial educational service providers, such as coaching institutions, under the standard rated regime. Similarly, in the case of health services, while exemptions should continue to be granted to supplies to support the provision of basic and essential lifesaving services, consideration should be given to taxing non-specialized services (e.g., yoga, acupuncture, massage centers, medicines sold by pharmacies without doctors' prescription). In certain instances, exemptions could become less relevant. In this context, the authorities should review the list of exempt items contained in Schedule 5 of the EACCMA to eliminate exemptions that can no longer be justified or those that cause imperfect competition with locally produced products.

e) **Reform the system for using deemed VAT:** Similar to the approaches adopted by regional peers and to mitigate government cash flow during the implementation of aid-funded projects, authorities should consider exempting supplies intended for the direct and exclusive use

39. Jensen, L.; T. Minh Le, and others, 2016 "Assessing Domestic Revenue Mobilization: Analytical Tools and Techniques", October 2016 . World Bank Washington DC.

of aid funded projects, instead of utilizing the deemed VAT approach. This would ease the administrative challenges associated with the deemed VAT approach and reduce leakages. A rolling list of active aid funded projects should be available to the URA as a basis for determining these exemptions.

f) Rationalize the VAT system for mobile communications services: The authorities should explore options that ensure that airtime is standard rated at the point of supply by the telecommunication company mobile service provider. All other players in the airtime value and distribution chain should be exempt to minimize leakages. This reform, aligns to the current trend, which is making scratch card technology obsolete, as airtime is purchased and loaded through electronic channels, including mobile money.

> Personal Income Tax (PIT) is the third largest source of collected domestic revenues in Uganda, contributing to roughly 18 percent of total tax revenues. Uganda's rate of productivity for PIT is less than 10 percent. In developed countries, personal income taxes contribute to around 25-40 percent of total tax revenues.

5.2 Personal Income Tax (PIT): Have everyone pay to make the system fairer while generating more revenues

Personal Income Tax (PIT) is the third largest source of collected domestic revenues in Uganda, contributing to roughly 18 percent of total tax revenues and amounting to a value of around 2.3 percent of GDP, one of the lowest proportions in the East African region.[40] Uganda's rate of productivity for PIT is less than 10 percent. In developed countries, personal income taxes (excluding payroll taxes or social security contributions) contribute to around 25-40 percent of total tax revenues. In keeping with international good practice, Uganda has adopted a broad base to tax personal incomes, covering incomes from: (i) personal employment; (ii) business; and (c) property.[41] Despite this, the contribution of PIT to tax revenues is lower than is the case for many regional comparators, mainly because of lower average per capita incomes; a relatively low share of working-age individuals in the formal sector; the granting of extensive exemptions; and a weak compliance culture.[42]

In principle, Uganda's PIT regime supports core policy objectives on equity and administrative simplicity.[43] A minimum threshold has been established to ensure that extremely low-income earners are not taxed, after which there are three tax brackets, at 10, 20 and 30 percent, on increasing income thresholds, with those earning a figure in excess of UGX 120,000,000 per annum being required to pay an additional 10 percent on the value of this excess. The system

40. Rwanda's collects about 3.5 percent of GDP in PIT revenue, Kenya about 6 percent of GDP and Tanzania about 3 percent of GDP. Burundi, with a lower collection of 2 percent of GDP, compares to Uganda's 2.3 percent.

41. Under the personal employment income, all type of wages, salary, fees, bonus, allowance and fringe benefits are subject to taxation. Business includes any gains of revenue or capital nature. Property income includes any dividends, interest, annuity, natural resource payments, rents, and royalties

42. The TADAT 2015 Report indicated that on time filing ratio for PAYE taxpayers in 2013/14 was 59 percent.

comprehensively uses withholding practices. With higher income earners being subject to a relatively greater tax burden than low income earners, Uganda's income tax system is progressive at the outset. However, the use of tax reliefs and tax avoidance practices by certain groups offsets the progressiveness of the system. The same bracket structure applies to non-residents as residents, but with higher rates for the non-residents. In accordance with the growing trend internationally, Uganda taxes her residents on a global basis, with non-residents taxed on the basis of income sourced in Uganda. While capital gains are deemed to be gross income and subject to normal taxation, interest, dividends and rental income are subject to scheduler taxation, which becomes the final tax.

In reality, however the objectives on equity and administrative simplicity are not being met, due to a number of gaps and issues in the Uganda's PIT system. These are listed below:

> The authorities should establish a system to evaluate exemptions to eliminate inefficiencies and anomalies and to rationalize the VAT base. It is necessary to balance the value of social externalities against the cost of exemptions.

(i) **PIT outcomes are mainly constrained by exemptions to select group of formal employees, and by informality in many sectors. Exemptions apply to specific groups of employees in the formal sector, particularly those in the legislature, security and judicial services sectors.** Tax on employment income is a major source of PIT, with most of the taxes derived from a small group of formal private and government sector employees, including public servants, of which there are about 415,000. In total, about 16 percent of the workforce is employed in the wage sector.[44] However, the majority of those employed in the security and judicial services sectors are exempt, as are those employed under technical assistance agreements. Similarly, the allowances provided to members of parliament are exempt. These exemptions create perceptions of unfairness and reduce the value of collected taxes. For taxation to have a positive impact in terms of accountability and compliance culture, all taxpayers must feel that they are obliged to pay taxes in line with the tax code, with this applying especially to office bearers and those regarded as being in a privileged position. It is worth noting that in 2010, Kenya reformed its constitution to include a stipulation that no law may be enacted to exclude a State Officer from obligations to pay tax based on their office. This reform was clearly intended to foster a perception of fairness.

44. World Bank, 2013, Uganda Economic Update (2nd Edition); Jobs: Key to Prosperity.

(ii) **The level of taxes collected from those in the informal sector remains very low.** Those employed in the informal sector, particularly in agriculture, are hard-to-tax, have a low compliance culture, and are currently marginally represented in terms of their contribution to collected taxes.

(iii) **Tax brackets are not inflation-indexed to preserve value.** Uganda has recorded average annual inflation rates of around six percent over the past decade, with some years in which double-digit inflation rates have been recorded. These high rates cumulatively erode the value of any variables denominated in nominal terms. Despite this, there has not been any adjustment to the thresholds that define tax brackets. While this bolsters nominal revenues, it may undermine equity and create perceptions that taxpayers are being required to pay more than they can afford. Ideally, a system of indexation should be applied to the thresholds that define brackets, reducing pressures for tax exemption and increasing a culture of compliance. No such system is yet in place in Uganda.

Reform Options

To make Uganda's PIT regime fairer and to increase the value of collected tax revenues, the authorities should consider implementing the following measures:

a) **The elimination of unfair, inefficient exemptions:** In the short term, the authorities should conduct a review of PIT exemptions to identify those that are inefficient, that are overly generous, or that create perceptions of unfairness.

> The Government could improve transparency and accountability by establishing clearer linkages between taxation and public expenditure and by ensuring that tax administration and enforcement was implemented more equitably.

The value of revenue from excise tax has declined steadily over the past several decades from

3.5% → 2.5%

system of indexation should be applied to the thresholds that define brackets, reducing pressures for tax exemption and increasing a culture of compliance

b) **Intensified enforcement:** The authorities should conduct dedicated campaigns to ensure that all income earners declare their incomes and pay their taxes in compliance with the tax code.

c) **Review of the system for setting income tax bracket thresholds:** In the medium term, the authorities should consider indexing the thresholds for income taxes to preserve their value from inflation. This may result in perceptions of greater fairness and remove perceptions that the tax burden is excessive, thus fostering a culture of compliance.

5.3 Excise tax: remove exceptions and preserve value through indexation

The value of revenue from excise tax has declined steadily over the past several decades, from about 3.5 percent of GDP in the 1990s to about 2.5 percent over the past decade. The decline is primarily due to a range of excise duty exemptions, which collectively reduce revenues by about 0.43 percent of GDP. Excise duty is the fourth most significant contributor to collected tax revenues, contributing to an average of 9 to 10 percent of total revenues over the last ten years. In keeping with standard international practice, Uganda applies excise duties to manage negative externalities that could otherwise emerge through the uncontrolled use or production of particular products. While the value of Uganda's collected excise taxes is relatively high compared to regional peers, the decline over the past several decades is largely attributable to the reduced production of one key product, tobacco, with British American Tobacco closing its production facility in the late 1990s, and selective implementation of excise policy, which does not address externalities. While a new Excise Act was promulgated in 2014, four years later, excise


Processing soft drinks at Century Bottling Company (u) Ltd, Kampala (World Bank / Morgan Mbabazi, 2016)

tax regulations have not yet been developed to implement all aspects of the new law.

The main shortcomings of Uganda's excise regime include the following:

(i) **Leakages related to excise duty expenditures:** By 2016, the revenue forgone from excise duty exceptions to the regular excise duty system[45] was estimated to reach a value of 0.43 percent of GDP. These exceptions include preferential excise rates applied on similar goods (beer, cigarettes, spirits and wines) and items exempted from excise tax (automobiles and aviation fuels).

(ii) **At the product level, there are specific issues that have a negative impact on revenue outcomes.** These include the following:

> The Centre for Tobacco Control in Africa estimates that the health costs associated with smoking in Uganda reach UGX 328.82 billion. In simple economic terms, this outweighs the economic benefits derived from taxation on tobacco use, the value of which amounts to around UGX 211.15 billion.

a. **Tobacco:** Considering the significant negative externalities associated with smoking, tobacco is taxed relatively lightly. In Uganda, the smoking prevalence rate is estimated to stand at around 16.4 percent of the adult population. The Centre for Tobacco Control in Africa estimates that the health costs associated with smoking in Uganda reach UGX 328.82 billion. In simple economic terms, this outweighs the economic benefits derived from taxation on tobacco use, the value of which amounts to around UGX 211.15 billion. In a recent diagnostic conducted by the World Bank,[46] it was established that excise tax rates on cigarettes could be increased to UGX 165,000 per 1,000 cigarettes. Other issues relate to the imposition of preferential excise rates on locally produced cigarettes, despite provisions of the Tobacco Control Act 2015 and the WHO Protocol on Tobacco that deprecate this practice. Different excise duty rates are applied on cigarettes sold in packets with hinge lids and soft caps, which also does not conform to best practices. In short, there is room both to increase rates generally and to apply greater consistency in the imposition of excise duty.

b. **Alcohol:** The manner in which alcoholic products are classified and defined and the differential excise duty rates applied to different categories create opportunities for manipulation. For example, excise duty on beer or wines is determined based on source of raw material instead of alcohol content. While the optimal excise rate for beer in Uganda stands at around 60 percent, some types of beers attract lower excise duty rates. Consequently, collection of excise duty on beer has not responded well to increases in GDP, with buoyancy and elasticity rates of 0.69. By contrast, in the case of the collection of duty on spirits, the buoyancy rate stood at 2.13 and elasticity rate at 1.97, indicating a good response to increased GDP.

45. "A handbook of Tax Simplification", publication by Investment Climate Advisory Services, 2009.

46. World Bank, 2017, Excise Duty Diagnostic

Sticks of cigarettes (World Bank / Morgan Mbabazi, 2016)

Considering the significant negative externalities associated with smoking, tobacco is taxed relatively lightly

c. **Non-alcoholic drinks:** The system of classification for nonalcoholic drinks does not enable the proper content identification to tax products appropriately. Secondly, products such as energy drinks, flavored milk and bottled tea are outside the excise tax net.

d. **Petroleum products:** The collection of excise duty on petroleum products has not responded well to increases in GDP (buoyancy of 0.71; elasticity of 0.17), partly because specific rates have been eroded by inflation. In addition, aviation fuel was effectively removed from the tax base in 2014. More generally, motorized vehicles (cars, motorcycles etc.) are not subjected to excise duty. An environmental levy is currently being imposed on vehicles older than five years. While this measure may be imposed to address negative externalities associated with older vehicles, it also limits the tax base and may distort consumer choices. Contrary to best practice and to the tax policies of EAC partner states, Uganda maintains a narrow definition of the excise duty base on petroleum products, excluding products such as petroleum derivatives or aviation fuel.

(iii) **The excise regime applies specific rates or a mixture of specific and ad valorem rates on half of the sixteen categories of excisable products, with these sorts of rates applying to soft drinks, cement, fuel, sugar, spirits, beers, cigarettes and telecommunication services.** There is no indexation policy to factor in the impact of inflation on specific excise tax rates. Thus, additional resources are required to recalibrate rates to adjust for this impact, or the value of the tax base will erode.

(iv) **The structure of Uganda's tax administration does not support the effective implementation of excise tax policy.** Over the years, administrative reforms to the URA have eliminated the placement of resident tax officers in factories and production facilities.[47] There is no dedicated URA enforcement unit that targets excisable goods, nor has the URA established the structures, processes or systems to implement the provisions of the Excise Act, 2014. Despite Uganda being a signatory to the WHO Framework Convention on Tobacco Control, the URA has not yet operationalized Track and Trace Systems that are linked with global information sharing systems. As a result, Uganda fails to meet the requirements of the WHO Protocol on tobacco control and is missing opportunities to reduce illicit trade in tobacco and/or other products.

47. Resident tax officers are crucial in Uganda, where excise duty rates are determined based on source of raw materials.

> Vehicle excise tax rates could be designed to signal the Government's policy intent of lowering CO2 emissions and encouraging the use of fuel-efficient vehicles

Reform Options

To improve the efficiency of the excise duty regime, the authority should consider the following measures:

To improve the excise duty policy framework, the authorities should consider the following will:

a) Indexing specific rates to preserve value in the context of inflation;

b) Streamlining policies related to the imposition of excise duty on tobacco by creating a single tier tax rate structure for all cigarettes, thus ensuring that all forms of cigarettes are covered in the excise regime and treated equally. The authorities should also implement Track and Trace Systems to comply with the WHO protocol on Tobacco control and to increase the ability to control illicit trade.

c) Rationalizing policies related to the imposition of excise duty on alcohol by using alcohol content as the point of reference for establishing the level of duty. They should also ensure that all forms of alcoholic beverages (e.g. non-malt beers, mead and powdered beer) are included in the excise regime.

d) Streamlining policies related to the imposition of excise duty on non-alcoholic drinks by broadening the classification of the tax base to include substitute non-alcoholic products. Standard nomenclature should be adopted to define taxable non-alcoholic items. Taxes on non-alcoholic beverages should not be earmarked.

e) Streamlining policies related to the imposition of excise duty on petroleum products by: (i) reviewing the list of aviation or jet fuel importers to confirm that they meet the requirements for exemption; (ii) revisiting tax policies with a view to imposing excise tax rates on the basis of the energy content in fuels; and (iii) including residual oils, medium oils and preparations in the excise tax base.

f) Reviewing the environmental tax on motor vehicle and possibly replacing it with a broad-based and progressive excise tax on motorized vehicles. The excise tax rates could be designed to signal the Government's policy intent of lowering CO2 emissions and encouraging the use of fuel-efficient vehicles.

To improve the administration of excise duty administration, the authorities should consider the following measures:

a) In the short term, regulations pursuant to S 16 of the Excise Tax Act, 2014, should be developed and enacted to support the implementation of the Act.

b) The URA should implement the Excise Act, 2014, by licensing the excise goods/services players; stopping suspended excise duty, remissions and refunds; and aligning excise tax returns to the new law.

c) The authorities should implement the Track and Trace (T&T) systems, with particular attention to updating project plans and developing policies in consultation with key stakeholders.

d) In the medium term, the authorities should review the impact of the exemption on aviation fuels to determine if these result in reduced air-ticket prices as a result of the exemptions. If the exemptions do not result in lower ticket prices for passengers, consideration should be given to removing the exemption.

e) URA must establish the appropriate organizational structures to implement existing excise duty policies effectively. Amongst other measures, this may involve deploying tax officers in factories to control excisable materials and expanding the mandate of physical enforcement units to specifically focus on high value, high risk and/or exempted excisable items, such as aviation fuel.

> Uganda's collection of CIT is low compared to that of Kenya, where the value of collected CIT amounts to 3.9 percent of GDP. At less than 10 percent, Uganda records a low rate of CIT productivity, considerably lower than Kenya (14 percent) or Ghana (25 percent).

5.4 Corporate Income Tax: Suppress the excessive use of tax reliefs to significantly enhance revenue yield

Corporate Income Tax (CIT) is the most significant tax to which businesses are subject, with this tax generating revenues to a value of up to 2 percent of GDP. Accounting for 7.5 percent of the total value of tax revenues, CIT is the fifth most significant contributor to tax revenues, with this proportion very low compared to the average for EAC and SSA countries. The corporate income tax base is the net profit derived by an individual company, with net profit defined as the gross revenue after subtracting all deductible expenses from total sales. All capital gains are treated as ordinary revenue for tax purposes. Deductions are allowed for all expenses incurred exclusively for the conduct of the business. Also, any losses incurred in the production of income are tax deductible. Uganda's CIT rate of 30 percent is only slightly below the average rate for SSA (32.8 percent) and low-income countries (31.9 percent).

Uganda's collection of CIT is low compared to that of Kenya, where the value of collected CIT amounts to 3.9 percent of GDP. At less than 10 percent, Uganda records a low rate of CIT productivity,[48] considerably lower than Kenya (14 percent) or Ghana (25 percent).[49] Amongst other reasons, this low productivity is due to the following causes:

48. Represents how well the corporate income tax does in terms of revenue collection, given the tax rate. CIT productivity is the portion of GDP in revenue that is mobilized for each point of CIT rate.

49. Data source: US Agency for International Development: collecting taxes series 2007-08 to 2012-13.

50. For instance, in addition to the exempt corporate incomes, investors located in industrial zones are entitled to duty exemption on raw materials, plant, machinery and other inputs, stamp duty exemption, duty drawback on imports of goods from domestic tariff areas, no export tax on exports and exemption of withholding tax on interest on external loans and dividends repatriated to get relief from double taxation. New agro-processing investment set up outside of a 30-kilometer radius of Kampala are exempt from income tax. While some exemptions have been rolled back from 2014, the incentives are still very generous, especially with the provision of initial depreciation of 50 percent for all business assets and 75 percent if the business is out of the select urban areas.

51. These are deductions which taxpayers claimed as evidenced by tax return data availed to URA beyond expenses incurred in deriving income included in gross income used for taxation.

The real estate sector claims the highest proportion of losses carried forward	76%
Information and communication	57%
Transport	44%
Accomodation	40%
Agriculture	18%

(i) **The system of exemptions and investment incentives means that the CIT system is non-neutral.**[50] It has been estimated that in the period from 2014 to 2016, the value of revenues foregone because of exemptions amounted to between 0.7 to 2.33 percentage points of GDP each year. If these revenues have been collected, the value of collected CIT would have almost doubled from the current figure of 2 percent of GDP. The bulk of the tax expenditure has gone to the service sectors, mainly the financial and insurance services, extra-territorial agencies, health and other services.

(ii) **In the period from 2014 to 2017, the annual average value of other allowable deductions[51] amounted to 0.42 percent of GDP, which reduced the chargeable income.** In addition, the depreciation rules are quite generous compared to those in other countries in the region. It is estimated that tax depreciation and capital allowances are consistently 125 percent higher than financial accounting depreciation. The alignment of accounting to taxation depreciation rules may generate additional benefits to Uganda in terms of increased revenues, while at the same time simplifying the tax administration system and reducing tax compliance costs, as taxpayers would not have to recalculate their financial accounting depreciation to meet tax reporting requirements.

(iii) **Uganda's policy for allowing perpetual carry forward of tax losses creates inefficiencies and opportunities for avoidance.** The real estate sector claims the highest proportion of losses carried forward (76 percent), followed by information and communication (57 percent); transport (44 percent); accommodation (40 percent); and agriculture (18 percent). The magnitude of the tax losses claimed and carried forward suggests that the administration is unable to control possibly fictitious claims, which means that it is unable to guarantee integrity of the tax declarations.[52] While other low capacity countries also apply loss carry forward mechanisms,[53] Uganda's methodology is particularly prone to risk because it is perpetual in nature, which means that some companies may be tempted to engineer fictitious perpetual losses to avoid taxation.

(iv) **While Uganda applies a generous 'thin capitalization rule' to foreign companies, it does not extend this rule to domestic companies.** This creates inequalities and possibly results in the erosion of the CIT base. While there are no debt-to-equity restrictions on domestic resident companies, if a foreign-controlled resident company other than a financial institution has a foreign debt-to-equity ratio in excess of 2:1, interest deductions are disallowed on the debt to the extent that it exceeds this ratio. The Government could introduce thin capitalization rules for domestic companies and increase the ratio to a limit of 3:1 or 4:1 for both

52. Taxpayers are allowed to manually enter the brought forward loss in the income tax return.

53. In EAC Rwanda, Kenya limit loss carry forward to 5 and 9 years respectively. Tanzania ring-fences losses carried forward and imposes an alternative minimum tax of 0.3 percent on gross turnover for companies that make losses for three years in the third year. Among developed nations, Canada and Chile limit loss carry forward to 7 years.

54. The negative chargeable income arises when the allowable deductions are higher than the gross incomes generated by firms

domestic and foreign companies. This is particularly necessary given that domestic companies have begun to use creative tax avoidance methods, as is often the case with foreign companies.

Overall, leakages from tax reliefs, estimated to be amounting to 1.0 to 2.0 percent of GDP, are about the same level estimated for Kenya, which implies other factors are responsible for the low performance.

While Uganda's nominal tax rate is 30 percent, the effective tax rate on net chargeable income has consistently been negative, at an average rate of 14 percent over the last four years.[54] However, the burden is not equally spread. According to 2016 data, manufacturing had an effective rate on gross chargeable income of 49 percent; water of five percent; wholesale/ retail of 25 percent; ICT of 33 percent; and households of 16 percent. All these sectors return negative effective rates on net chargeable income when losses carried forward are deducted from the current year's gross chargeable income.

Reform Options

To increase the revenue yield from the business sector, the Government could consider the following measures:

a) In the short term, the authorities should review provisions related to losses carried forward and consider limiting the period for which these losses may be carried forward to a minimum of 5 years (i.e. period allowed to tax payers to keep records)

b) The authorities should rationalize the list of exemptions to ensure that incentives that address specific market failures remain on the tax code.

c) The authorities should review provisions related to 'other allowable expenditures' to determine the extent to which these deductions can be justified and to examine why these deductions cannot fit into the class of deductions described by the Income Tax Act as 'expenditures incurred in the production of income included in gross income.' Following the review process, the Government could consider limiting the deductibility of these expenditures. In addition, to encourage compliance with withholding tax regimes, the Government should include new policy-oriented prohibition on deductible expenses. For example, expenses subject to withholding tax, such as wages or interest, should not be deductible if withholding taxes were not remitted on time to the URA.

d) In the medium term, the authorities should consider simplifying the tax regime by aligning accounting depreciation procedures with tax depreciation procedures.

e) The authorities should develop a Tax Expenditure Fiscal Governance Framework to guide the process of assessing new tax exemptions.

"

The authorities should rationalize the list of exemptions to ensure that incentives that address specific market failures remain on the tax code.

06 ENHANCE EFFICIENCY OF REVENUE ADMINISTRATION

Uganda Revenue Authority – Staff at work in head office in Nakawa, Kampala (World Bank / Morgan Mbabazi, 2016)

An assessment to establish strengths and areas of improvement in the customs administration has been commissioned, spiraling offsets, carried forward losses or tax bases that are not tapped into point to URA capacity

There is scope to increase the efficiency of Uganda's tax administration system. The failure to control spiraling offsets and carried forward losses and to effectively tap all tax bases suggest that a number of capacity gaps need to be addressed. In terms of cost effectiveness, the recurrent cost of administration is about 1.7 percent of the total value of revenues collected. This is higher than the rate of around 1 percent or less recorded by most OECD countries.

In many countries, this rate declines as more efficient systems of revenue administration are implemented, including systems involving more advanced technologies. Kenya's rate stood at about 1.2 percent in 2016, with this rate having steadily declined over the past decade. The rate recorded by Uganda is roughly similar to the rates of Tanzania and Rwanda, which range between 2 to 3 percent. In Uganda, despite an ambitious modernization program, not all revenue collection operations have been fully computerized. Even though Uganda has implemented e-taxation for a number of years,[55] the process is not yet complete, with a range of processes still conducted manually. Some private sector actors have noted that it is not possible to link their accounting systems with the URA system to file returns and provide the necessary back information.

According to an IMF Tax Administration Performance Assessment (TADAT) for Uganda completed in August 2015, a key strength of URA was the good use of IT system (e-Tax) in the delivery of services. Although the e-Tax impact assessment has not yet been done, anecdotal evidence points to positive results.[56] Despite the positive outcomes from e-Tax, several challenges have been noted. These include intermittent system availability, slow response times, unused modules or data and new laws which are not yet ably supported by the system.[57] An assessment to establish strengths and areas of improvement in the customs administration has been commissioned. Spiraling offsets, carried forward losses or tax bases that are not tapped into point to URA capacity (skillsets, staff numbers etc.) constraints.[58] Further value chain, competence or strategic architecture analysis of URA have not yet been conducted.

55. Online registration, filing and payment compliance is available on a 24-hour basis using the eTax system.

56. Domestic tax revenues as a portion of total revenues increased from 47 percent in 2007 to 56 percent in 2016. As a percent of GDP domestic revenues rose from 6.6 percent to 7.8 percent in same period. Domestic tax expenditure to revenue ratio decreased from 2 percent in 2007 to 1.2 percent in 2014. A 24-hour service was introduced. By June 2014, taxpayer base stood at 245,067(37,621 corporate entities and 207,446 individuals) up from 30,000 in 2009/2010

57. Examples include the Tax Procedure Code Act, 2014 the Excise Act, 2014 and the Petroleum tax regime.

58. More than 36 percent of staff have less than six years' experience in tax administration. Another 24 percent have spent 6-10 years in URA. This speaks volumes to the need to invest in technical, general, inter-personal and leadership skills amongst URA staff.

The rate recorded by Uganda is roughly similar to the rates of Tanzania and Rwanda, which range between

2% → 3%

According to an IMF Tax Administration Performance Assessment (TADAT) for Uganda completed in August 2015, a key strength of URA was the good use of IT system (e-Tax) in the delivery of services. Although the e-Tax impact assessment has not yet been done, anecdotal evidence points to positive results.

Reform Options

- The Government should review the existing ICT systems and processes to identify options to strengthen capacity to deepen the computerization of URA's operations. As part of this initiative, it should implement technological solutions that have been demonstrated elsewhere to facilitate the collection of increased revenue. For example, implementing the Tobacco Trace and Track systems could be a significant step towards improving URA's capacity to combat illicit trade.

- The Government should devise mechanisms for sharing information across institutions.

- The Government should invest in cleaning and expanding the tax register to increase its level of accuracy and to generate confidence in the system. Registration should be encouraged both through the provision of rewards for compliance and the imposition of sanctions for non-compliance.

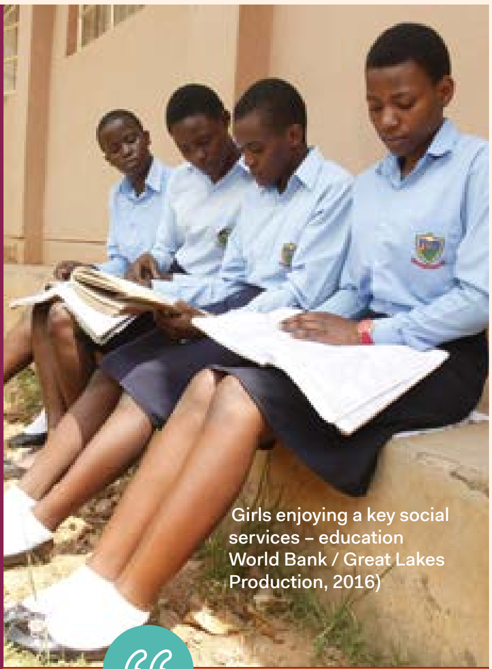
- The Government should design and implement a strategy to build capacities in the area of both tax policy and tax administration over the medium and long term. In particular, priority should be given to closing gaps in core functions such as data analysis and forecasting, auditing and investigative functions.

- The Government should review the functions of both the URA and local government tax administration units to identify the areas in which the respective entities have a competitive advantage so that the overall taxation system works effectively and includes as many taxpayers as possible.

An untapped potential also lies within the non-tax revenue arena, where the value of revenues currently amounts to a mere 0.2 percent of GDP. Uganda's performance in terms of the collection of non-tax revenues is considerably worse than that of Kenya (0.4 percent of GDP); Tanzania (0.5 percent); and Rwanda (0.9 percent). Building the revenue administration capacities of local governments and streamlining the administration of property taxes and user charges would enhance the revenues of these governments. Moreover, while local governments currently significantly underutilize user fees, they have a number of benefits, including promoting economic efficiency (cost recovery). The further introduction of user fees would have the additional benefit of reducing the central government's fiscal burden. Furthermore, with preparations for the commercial production of oil underway and with the growth of the mineral sector, the development of an effective framework to collect revenues from these sources is crucial.

Going forward, the most critical issue remains the need to improve accountability and enforcement, Government has decided that all NTR should be collected by URA and utilized through the Concolidated Fund. Enforcement by the Ministries, Departments and agencies (MDAs) will be key in ensuring increased yields, while leveraging URA's collection strengths.

07 STRENGTHEN THE SOCIAL CONTRACT TO IMPROVE TAX COMPLIANCE



Girls enjoying a key social services – education World Bank / Great Lakes Production, 2016)

There are significant weaknesses with public service delivery in Uganda. The management and delivery of infrastructure projects is poor, with wide spread perceptions of corruption

Taxation can provide an incentive for citizens and Government to enter into a mutually beneficial social contract. This calls for citizens to accept and comply with the taxation regime, with the Government being obliged to ensure the rule of law and provide public services. As a result, citizens receive improved service delivery while the state receives more predictable tax revenues. Citizens should be able to determine whether funds are used appropriately and responsibly, as reflected by effective service delivery.

Unfortunately, there are significant weaknesses with public service delivery in Uganda. According to World Bank Service Delivery Indicators (SDIs)[59] , in 2013, close to half of all health workers (49 percent) in public facilities could not accurately diagnose five tracer conditions and follow clinical guidelines. Less than half (47.9 percent) of all public health facilities had adequate infrastructure, while more than half (52 percent) of public health providers were not present in the facility. In the education sector, less than one in five (19 percent) of public school teachers showed mastery of the curriculum and more than one out of four (27 percent) teachers in public schools were not present at work. The management and delivery of infrastructure projects is poor, with wide spread perceptions of corruption. Uganda continues to lag behind its regional neighbors in indicators related to Government effectiveness.[60] These factors weaken the social contract between government and the citizens. These, combined with the lack of awareness and transparency regarding the collection of taxes and the use to which revenues are put, result in a low level of trust in the tax management system.

59. World Bank Service Delivery Indicators, 2013; http://data.worldbank.org/data-catalog/service-delivery-indicators

60. World Wide Governance Indicators (2016)

In the education sector, less than one in five (19 percent) of public school teachers showed mastery of the curriculum and more than one out of four (27 percent) teachers in public schools were not present at work. The management and delivery of infrastructure projects is poor, with wide spread perceptions of corruption.

Reform Options

The revenue mobilization agenda could benefit from stronger governance and accountability, with equity as one of the governing principles. A taxation system that is seen to be fair and transparent would enhance compliance. To achieve this, the following measures should be considered:

(i) Improve transparency in overall administration and collection;

(ii) Strengthen the regularity and clarity of reporting of tax through the budget process;

(iii) Devise mechanisms to demonstrate the linkage between taxation, public expenditure and effective service delivery (for example, through the demonstration of enhanced service delivery by MDAs during the URA tax appreciation week);

(iv) Engage with CSOs to enhance dialogue on tax policy implementation and build alliances with key stakeholders including members of parliament, private sector representative organizations and NGOs;

(v) Develop the new DRM-S process as a vehicle to build coalitions and improve coordination, with clear linkages to economic transformation, increased jobs and the achievement of other government goals.

A busy day in downtown Kampala (World Bank / Morgan Mbabazi, 2016)

08 CONCLUDING REMARKS

With Uganda's current level of performance, reforms both within and outside the tax system are needed to increase the value of collected revenues to enable a country to effectively manage its debt and to deliver public services of sufficient quality

Uganda has the potential to significantly increase the value of its collected domestic revenues, which in turn would provide the authorities with greater fiscal space and increased resources to manage fiscal policies and to provide public services. Despite Uganda's good macroeconomic performance, domestic tax revenue mobilization still ranges at the relatively low level of 13 to 14 percent of GDP.

If Uganda was to achieve the same level of performance with peers with similar characteristics, it could increase the value of collected revenues to fulfill their potential, estimated at between 18 and 23 percent of GDP. It could increase these revenues by between 4.0 to 5.0 percentage points of GDP by significantly reducing the revenue losses it currently incurs as a result of policy discretion on tax expenditures. With Uganda's current level of performance, reforms both within and outside the tax system are needed to increase the value of collected revenues to enable a country to effectively manage its debt and to deliver public services of sufficient quality to meet the needs of its expanding population.

For Uganda to achieve its full potential in terms of tax revenue mobilization, it has to include a far greater proportion of businesses and individual income earners into the tax net; to use existing tax instruments more efficiently; and to increase the efficiency of tax administration. Firstly, the easiest and most cost-effective measure would involve increasing the productivity of tax instruments, which could be achieved by refraining from excessive provision of tax reliefs. To achieve this, streamlining the governance framework for tax expenditures is critical. Secondly, a deliberate effort to streamline the taxation of agriculture and to identify and incentivize informal firms to formalize is required. To achieve this, stronger linkages should be established between existing institutions involved in the registration and management of information on firms. These measures should be combined with the provision of incentives to other sectors (e.g. the financial sector) to support a more rapid process of formalization and financial inclusion. Thirdly, the authorities could collect additional revenues by improving the efficiency of revenue administration. This could be achieved by leveraging modern technological innovations; by cleaning and expanding the tax register; and by sustained measures to build capacities in both tax policy and tax administration. These measures must be followed by developing and utilizing synergies between URA and other

If Uganda was to achieve a certain level of performance, it could increase the value of collected revenues between

18% → 23%

A deliberate effort to streamline the taxation of agriculture and to identify and incentivize informal firms to formalize is required, using stronger linkages established between existing institutions involved in the registration and management of information on firms.

entities, especially local governments, to identify taxpayers. While some of these measures can be implemented effectively in the short term, optimal results will only be achieved through a consistent and deliberate effort to address the key constraints on revenue mobilization, even if the required measures are difficult and take time to implement and bear fruit.

To support the reforms, the authorities should formulate and implement strategies that promote a culture of compliance with the tax regime, including through high-level political messaging. All office bearers, including the president, cabinet members, legislators and key figures in civil society need to make deliberate efforts to address impressions that Uganda does not need tax revenues, or that the agriculture or select taxpayer groups are exempt from tax obligations. Removing exemptions for government institutions and select groups of public servants could address perceptions of unfairness through a 'lead by example' approach to building a stronger culture of compliance. Other reforms could focus on building a consensus on what incentives should be reasonably extended to attract both domestic and foreign investments in Uganda.

The Government could also strive to strengthen the social contract by improving transparency and accountability; creating clear links between taxation and public expenditure; and implementing measures to achieve higher levels of equity in the areas of enforcement and tax administration. In addition to the annual URA revenue report, the URA could prepare and publicize a report that links collections by geographical source to valuable expenditure outcomes. The URA has invested heavily in the establishment of a taxpayer services division, which offers tax payers a host of online self-services and other services, including assistance, information, education, and outreach services. The authority also runs a call center that receives and resolves complaints from taxpayers.

Local governments also have the capacity to improve their revenue mobilization efforts. Currently, local governments' own source revenues (OSR) amount to 0.2 percent of GDP. This is lowest in the region (Kenya 0.5, Tanzania 0.4 and Rwanda 0.9 percent of GDP). This source of revenue has declined after the local governments disbanded graduated tax. This system was not implemented well, due to low capacity and political intervention. This lack of capacity also affects national taxes, Local governments' own source revenues (OSR)

0.2%

This is lowest in the region

KENYA **0.5%**

TANZANIA **0.4%**

RWANDA **0.9%**

percent of GDP

since many initiatives (e.g. the single business permit, property tax and user fees administration, etc.) are aimed at reaching hard to reach areas. These areas could benefit from an effective and well-resourced local government. For example, it has been established that the involvement of local governments in the identification of informal businesses and in the assessment of their tax liability often leads to better results than if this is conducted from the center. Going forward, the Government must enhance local government tax administration capacity. This would enable increased collections from other potential sources of revenue, including property tax and user fee regimes.

With both technical and non-technical approaches, well-planned, appropriately implemented reforms could contribute to the formulation of the Domestic Revenue Mobilization Medium-Term Revenue Strategy (DRMTS), which is currently being prepared by the authorities. The core aim of the developing strategy is to expand the tax base to increase the tax-to-GDP ratio, while at the same time ensuring that the tax system is equitable, with individual tax liabilities being set at appropriate levels for the income profiles of the tax payers. The formulation of the DRMTS creates opportunities for the establishment of a new social contract that will provide the Government with a strong basis to fulfil its mandate to provide services that meet the needs of the population.

ANNEXES

Table A1: Key Macroeconomic Indicators

Indicator	Unit measure	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 Est
Population	Millions	31.0	31.9	35.1	37.6	38.7	39.9	41.1	42.3	43.6
GDP	USD millions	20181.6	20262.3	23218.9	24663.1	27757.4	27573.2	24661.1	26282.8	27998.0
Per capita GDP	USD	651	635	662	656	717	691	600	621	642
GDP growth	%	5.6	9.4	3.8	3.6	5.1	5.2	4.7	4.0	5.5
Gross Domestic Savings	as % of GDP	19.7	19.5	17..7	21.7	18.8	17.1	18.2	20.1	21.0
Gross Investments	as % of GDP	12.5	12.3	28.2	29.5	26.7	24.6	24.9	25.3	25.2
Inflation (period average)	%	4.0	18.7	14.0	4.9	5.3	2.9	6.6	5.7	4.0
Exchange Rate (end-year)	UGX/USD	2177.6	2522.7	2504.6	2591.1	2538.0	2827.7	3443.0	3528.3	3675.0
External Sector										
Exports, f.o.b.	Million USD	2317.3	2297.8	2667.4	2912.1	2706.3	2738.4	2687.8	3163.7	3320.0
Imports - f.o.b.	Million USD	-4,116.8	-4,671.1	-5,241.5	-5,035.1	-5,073.5	-4,988.0	-4574.5	-4,718	-5,000
Current Account Balance	Million USD	-1497.2	-1732.6	-2030.9	-1517.3	-2051.7	-1876.5	-1208.8	-1047.9	-1061.9
Balance of Payments (overall balance)	Million USD	-229.6	606.0	-746.6	-338.0	-378.5	352.8	-101.5	-437.6	-104.0
Gross Foreign Reserves	Million USD	2384.7	2044.0	2643.8	2912.3	3394.0	2895.0	2962.0	3429.0	3734.0
External Debt	Million USD	2343.4	2904.9	3254.1	3825.2	4300.7	4380.1	5309.2	6014.1	6914.1
Foreign Direct Investment	Million USD	659.7	706.4	1243.9	939.9	1087.4	884.6	629.4	493.8	534.1
Monetary Sector										
Average Deposit Rate	%	2.0	2.1	3.2	3.0	3.1	3.3	3.2	3.3	2.7
Average Lending Rate	%	20.7	19.8	24.6	24.8	22.1	25.2	23.7	22.6	20.8
Growth in Money Supply (M3)	%	23.6	25.7	26.1	6.6	17.4	15.9	7.1	13.6	14.0
Government Finance										
Total Domestic Revenue	as % of GDP	10.5	13.6	11.2	11.3	11.6	13.2	13.8	14.3	13.7
Tax Revenue	as % of GDP	10.3	10.9	10.3	11.0	11.1	12.4	13.0	13.5	13.2
Non Tax Revenue	as % of GDP	0.3	0.2	0.2	0.3	0.5	0.6	0.7	0.7	0.4
Grants	as % of GDP	2.1	1.9	1.9	1.4	1.0	1.2	1.4	1.0	1.5
Total Expenditure and net lending	as % of GDP	16.7	19.1	15.6	16.2	16.6	18.7	20.1	19.2	19.3
Recurrent Expenditure	as % of GDP	10.5	12.7	9.1	9.0	9.5	10.0	11.0	11.3	10.8
Development Expenditure	as % of GDP	6.1	6.1	6.1	6.5	7.0	6.8	7.1	7.9	8.5
Fiscal Balance (overall)	**as % of GDP**	**-4.0**	**-3.6**	**-2.5**	**-3.5**	**-3.5**	**-4.4**	**-5.3**	**-3.5**	**-3.9**

Table A2: Growth and Structure of the Economy

Economic Activity	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/2017	2017/18 Est
Real GDP Growth Rates (%)	5.6	9.4	3.8	3.6	5.1	5.2	4.7	4.0	5.5
Agriculture	2.9	3.1	0.6	1.9	2.7	2.3	2.8	1.6	2.6
Industry	7.9	11.3	3.1	2.1	6.3	7.8	4.6	3.3	5.8
o/w manufacturing	4.5	7.8	2.7	-2.5	2.2	11.6	0.6	2.1	5.0
o/w construction	12.6	14.8	3.9	4.2	12.5	1.9	7.3	6.1	5.4
Services	7.0	11.7	4.0	5.4	5.4	4.8	5.9	5.7	6.6
GDP Shares (% of constant GDP)									
Agriculture	26.2	24.7	24.0	23.6	23.0	22.4	22.0	21.5	21.0
Industry	18.1	18.4	18.3	18.0	18.3	18.7	18.7	18.6	18.7
o/w manufacturing	8.5	8.4	8.3	7.8	7.6	8.0	7.7	7.6	7.6
o/w construction	5.8	6.1	6.1	6.1	6.5	6.3	6.5	6.6	6.6
Services	48.5	49.5	49.6	50.5	50.6	50.5	51.1	51.9	52.3
FISM and net taxes	7.2	7.3	8.1	7.9	8.1	8.4	8.2	8.0	8.0
GDP Shares by expenditure type (% of nominal GDP)									
Final Consumption Expenditure	85.9	87.4	85.6	81.9	82.7	86.2	84.5	83.5	83.7
Households	76.3	74.6	77.4	73.9	74.2	76.9	77.0	75.4	75.5
Government	9.6	12.8	8.2	8.0	8.5	9.3	7.5	8.1	8.2
Gross Capital Formation	25.6	27.5	27.3	28.4	27.3	24.6	25.5	23.9	23.8
Gross fixed capital formation	25.2	27.1	26.9	27.9	26.8	24.2	25.0	23.4	23.3
Charges in inventories	0.3	0.3	0.4	0.4	0.5	0.4	0.5	0.5	0.5
Net exports	-11.5	-14.9	-12.9	-10.3	-10.0	-10.8	-10.1	-7.4	-7.8
Gross domestic saving (% of GDP)	12.5	12.3	17.7	21.7	18.8	17.1	18.2	20.1	21.0
Public	2.9	3.3	2.4	3.1	2.3	2.9	2.8	3.3	4.6
Private	9.6	9.0	15.3	18.6	16.5	14.2	15.4	16.8	16.4

Table A3: Central Government Fiscal Framework (% of GDP)

Item	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 App. Budget	2017/18 Est
REVENUES AND GRANTS	**13.5**	**12.7**	**15.5**	**13.1**	**12.8**	**12.6**	**14.4**	**15.2**	**15.4**	**16.2**	**15.2**
Revenues	11.0	10.5	13.6	11.2	11.3	11.6	13.2	13.8	14.3	14.4	13.7
URA	10.6	10.3	10.9	10.3	11.0	11.4	12.4	13.0	13.5	13.6	13.2
Non-URA	0.4	0.3	0.2	0.2	0.3	0.5	0.6	0.7	0.7	0.8	0.4
Oil Revenues	0.0	0.0	2.5	0.7	0.0	0.0	0.2	0.1	0.1	0.0	0.1
Grants	2.6	2.1	1.9	1.9	1.4	1.0	1.2	1.4	1.0	1.8	1.5
Budget Support	1.5	1.1	1.1	1.0	0.3	0.3	0.3	0.4	0.3	0.3	0.3
Project Support	1.0	1.0	0.8	0.9	1.1	0.7	0.9	1.0	0.8	1.5	1.2
EXPENDITURE AND LENDING	**15.0**	**16.7**	**19.1**	**15.6**	**16.2**	**16.6**	**18.7**	**20.1**	**19.3**	**22.5**	**19.3**
Current Expenditures	9.5	10.5	12.7	9.1	9.0	9.5	10.0	11.0	11.0	10.4	10.9
Wages and Salaries	3.4	3.2	3.5	3.1	3.3	3.4	3.6	3.6	3.7	3.7	4.0
Interest Payments	1.0	0.9	0.9	1.0	1.4	1.4	1.6	2.0	2.6	2.7	2.7
Other Recurr. Expenditures	5.1	6.4	8.2	5.0	4.3	4.8	4.8	5.4	4.7	4.0	4.2
Development Expenditures	4.8	6.1	6.1	6.1	6.5	7.0	6.8	7.1	7.4	9.8	8.5
Net Lending/Repayments	-0.2	-0.1	-0.1	-0.1	0.6	0.0	1.6	1.8	0.6	1.9	0.7
Domestic Arrears Repaym.	0.8	0.2	0.4	0.5	0.1	0.0	0.3	0.1	0.2	0.4	0.5
OVERALL DEFICIT											
Overall Fiscal Bal. (excl. Grants)	-4.0	-6.1	-5.5	-4.4	-4.9	-5.0	-5.6	-6.7	-4.5	-8.0	-5.4
Overall Fiscal Bal. (incl. Grants)	-1.5	-4.0	-3.6	-2.5	-3.5	-4.0	-4.4	-5.3	-3.5	-6.2	-3.9
Financing:	**1.5**	**4.0**	**3.6**	**2.5**	**3.5**	**4.0**	**4.4**	**5.3**	**3.5**	**6.2**	**3.9**
External Financing (Net)	1.6	1.9	1.5	1.9	2.2	1.3	1.2	3.0	2.9	5.3	2.7
Domestic Financing (Net)	0.0	1.7	2.3	0.0	1.1	2.3	3.2	2.3	0.6	0.9	1.2
MEMORANDA ITEMS											
Nominal GDP (Shs billions)	34504	40946	47078	59420	64758	70458	76517	82903	91351	100552	101708

Table A4. Monetary indicators

	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 Est
Monetary Aggregates										
M3 as % of GDP	18.3	20.5	22.4	19.0	18.6	20.1	21.3	21.1	22.0	22.6
M2 as % of GDP	14.3	15.9	17.1	13.0	14.0	14.5	14.4	14.5	15.5	16.0
M3 growth rate (%)	25.0	33.2	25.7	7.2	6.6	17.4	15.9	7.1	13.6	14.0
M2 growth rate (%)	26.3	32.1	23.9	-4.2	15.7	14.1	8.8	8.9	16.0	14.8
Domestic Credit										
Total domestic credit (% of GDP)	9.2	11.9	16.0	11.8	12.5	13.8	16.7	17.2	16.2	16.5
Private sector credit (% of GDP)	10.4	11.4	14.3	12.7	12.4	12.9	14.3	13.7	13.3	13.5
Total domestic credit growth (%)	64.1	54.7	54.1	-6.5	13.4	21.9	32.3	10.8	2.6	13.4
Private sector credit growth (%)	31.3	29.8	44.1	11.6	6.0	14.1	20.3	4.3	5.7	12.5
Interest Rates Structure										
Average TB rate (period average, %)	8.4	5.3	7.6	17.2	10.3	9.9	12.0	17.8	13.2	9.0
Average lending rate (%)	20.9	20.7	19.8	24.6	24.8	22.2	21.6	24.0	22.6	20.8
Average deposit rate (%)	2.1	2.0	2.1	3.2	3.0	3.1	2.8	3.0	3.5	2.7

Table A5.1: Balance of Payments (percent of GDP unless otherwise stated)

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 Est
Current Account (incl transfers)	-8.1	-9.8	-9.5	-6.3	-7.6	-6.8	-4.9	-4.0	-3.8
Exports of goods	11.5	11.3	11.4	11.7	9.7	10.1	11.1	12.4	11.9
o/w coffee	1.3	1.8	1.9	1.7	1.5	1.5	1.4	1.9	2.0
Imports of goods	-20.4	-23.1	-22.6	-20.1	-18.3	-18.3	-18.9	-17.8	-17.9
o/w oil imports	-2.5	-3.4	-4.1	-4.1	-3.9	-3.4	-2.6	-2.6	-2.6
Services (net)	-2.1	-3.4	-1.7	-1.6	-1.2	-2.5	-2.7	-1.9	-1.7
Trade balance	-8.9	-11.8	-11.1	-8.5	-8.5	-8.3	-7.8	-5.4	-6.0
Income (net)	-1.7	-1.7	-2.0	-2.1	-2.2	-1.6	-1.7	-2.2	-2.5
Current transfers (net)	4.6	7.1	5.3	5.9	4.3	5.1	6.3	5.3	5.5
Capital and Financial Account	8.8	5.3	10.1	6.1	6.5	4.2	4.2	3.2	3.4
Capital account	1.0	0.8	0.8	0.1	0.3	0.4	0.5	0.6	0.6
Financial account	7.9	4.5	9.3	5.9	6.1	3.9	3.7	2.6	2.8
o/w direct investment	3.4	3.5	5.4	3.8	3.9	3.2	2.1	1.9	1.9
o/w portfolio investment	0.2	-0.0	-1.1	-0.2	0.0	-0.6	-0.7	-0.0	0.2
Overall Balance	1.2	-2.9	3.3	2.1	1.1	1.5	2.9	1.7	1.2
Gross International Reserves (million USD)	2384.7	2044.0	2643.8	2912.3	3394.0	2895.0	2962.0	3380.0	3475.0
Gross international reserves in months of imports	4.4	3.2	4.3	4.5	5.2	5.0	5.4	5.4	5.5

Table A5.2: Balance of Payments (US$ millions)

Variable	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 Est.
Current Account (incl transfers)	**-1,631.0**	**-1,984.0**	**-2,219.0**	**-1,582.0**	**-2,103.0**	**-1,958.0**	**-1531.0**	-1,058	-1,400
Exports of goods	2,317.0	2,298.0	2,660.0	2,912.0	2,706.0	2,738.0	2688.0	3169	3320
o/w coffee	262.0	371.0	444.0	423.0	404.0	400.0	352.0	490	548.0
Imports of goods	-4,117.0	-4,680.0	-5,241.0	-5,035.0	-5,074.0	-4,988.0	-4574.0	-4718.430	-5000
o/w oil imports	-501.0	-679.0	-947.0	-1,028.0	-1,090.0	-933.0	-646.0	-694	-739.0
Services (net)	-416.0	-691.0	-404.0	-405.0	-331.0	-561.0	-563.0	-438.5	-324.1
Trade balance	-1,800.0	-2,382.0	-2,581.0	-2,123.0	-2,367.0	-2,250.0	-1870.0	-1993.2	-2004.1
Income (net)	-335.0	-341.0	-471.0	-528.0	-610.0	-492.0	-492.0	-582	-687.0
Current transfers (net)	920.0	1,430.0	1,238.0	1,473.0	1,204.0	1,345.0	1411.0	1403	1,540.0
Capital and Financial Account	**1,786.0**	**1,081.0**	**2,357.0**	**1,519.0**	**1,813.0**	**952.0**	**1414.9**	**833**	**964.9**
Capital account	197.0	160.0	194.0	33.0	91.0	99.0	120	151	173
Financial account	1,589.0	921.0	2,163.0	1,486.0	1,722.0	853.0	1295	683	792
o/w direct investment	693.0	719.0	1,244.0	940.0	1,087.0	785.0	537	494	539
o/w portfolio investment	31.3	-2.1	-264.7	-47.0	26.0	-191.0	-151.0	-212.3	-104.0
Overall Balance	235.0	-597.0	759.0	534.0	378.0	-353.0	101.0	427	104.0
Gross International Reserves (million USD)	2,384.7	2,044.0	2,643.8	2,912.3	3394.0	2895.0	2962.0	3380.0	3475.0
Gross international reserves in months of imports	4.4	3.2	4.3	4.5	5.2	5.0	5.4	5.4	5.5
Memoranda items									
GDP at current prices (USHS billions)	40,946.0	47,078.0	59,420.0	64,758.0	70458	76517	82903	91351	101708
GDP at current prices (US$ millions)	20,181.4	20,262.5	23,237.3	24,663.1	27,757.5	27,102.7	24,079.0	26282.8	27998.0
Exchange rate (period average)	2,028.9	2,323.4	2,557.1	2,591.0	2538.339	2823.220	3442.957	3528.297	3632.7

Table A6. Inflation Rates (percentage changes)

Item	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 Est.
	FY	FY	FY	FY	FY	FY	FY	FY	FY	
CPI (average)	14.2	9.4	6.5	23.7	5.8	6.7	2.9	6.6	5.7	4.0
CPI (end of period)	10.9	4.6	4.0	15.4	6.4	3.0	4.9	5.9	6.4	3.8
Food (end of period)	27.9	16.5	9.3	12.8	-1.4	7.2	7.2	-2.1	18.1	3.0
Core Inflation (end of period)	8.9	6.7	5.7	19.5	5.8	2.9	5.0	6.8	5	3.5

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